

MVC CAPITAL, INC.  
Form 10-Q  
September 06, 2006

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**SECURITIES AND EXCHANGE COMMISSION**

**Washington D.C. 20549**

**Form 10-Q**

- þ** **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended July 31, 2006**
- or**
- o** **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File Number 000-28405**

**MVC Capital, Inc.**

*(Exact name of the registrant as specified in its charter)*

**DELAWARE**

*(State or other jurisdiction of  
incorporation or organization)*

**287 Bowman Avenue**

**2nd Floor**

**Purchase, New York**

*(Address of principal executive offices)*

**94-3346760**

*(I.R.S. Employer  
Identification No.)*

**10577**

*(Zip Code)*

**Registrant's telephone number, including area code:**

**(914) 701-0310**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **þ** No **o**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):  
Large accelerated filer **o** Accelerated filer **þ** Non-accelerated filer **o**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes **o** No **þ**

There were 19,093,929 shares of the registrant's common stock, \$.01 par value, outstanding as of September 6, 2006.

**MVC Capital, Inc.**  
**(A Delaware Corporation)**

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<b><u>Certifications</u></b>		

**Table of Contents****Part I. Consolidated Financial Information****Item 1. Consolidated Financial Statements****CONSOLIDATED FINANCIAL STATEMENTS****MVC Capital, Inc.  
Consolidated Balance Sheets**

	<b>July 31, 2006 (Unaudited)</b>	<b>October 31, 2005</b>
<b>ASSETS</b>		
<b>Assets</b>		
Cash and cash equivalents	\$ 10,469,188	\$ 26,297,190
Short term investments at market value (cost \$79,213,434 and \$51,026,902)	79,213,434	51,026,902
Investments at fair value (cost \$235,100,660 and \$171,591,242)		
Non-control/Non-affiliated investments (cost \$88,235,868 and \$74,495,549)	46,473,161	33,685,925
Affiliate investments (cost \$67,933,841 and \$40,370,059)	70,250,586	32,385,810
Control investments (cost \$78,930,951 and \$56,725,634)	95,478,840	56,225,944
Total investments at fair value	212,202,587	122,297,679
Dividend, interest and fees receivable	1,059,019	902,498
Prepaid expenses	2,360,212	364,780
Prepaid taxes	41,520	98,374
Deferred taxes	435,584	303,255
Deposits	205,000	
Other assets	63,247	88,600
<b>Total assets</b>	<b>\$ 306,049,791</b>	<b>\$ 201,379,278</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Liabilities</b>		
Provision for incentive compensation (Note 8)	\$ 5,834,389	\$ 1,117,328
Employee compensation and benefits	845,197	807,000
Other accrued expenses and liabilities	455,609	353,606
Professional fees	536,406	276,621
Payable for investment purchased		79,708
Consulting fees	9,064	3,117
Directors fees	(27,141)	2,898
Term loan	30,000,000	
Revolving credit facility	45,000,000	
<b>Total liabilities</b>	<b>82,653,524</b>	<b>2,640,278</b>

**Shareholders' equity**

Common stock, \$0.01 par value; 150,000,000 shares authorized; 19,092,028 and 19,086,566 shares outstanding, respectively	231,459	231,459
Additional paid-in-capital	358,585,836	358,571,795
Accumulated earnings	15,587,184	13,528,526
Dividends paid to stockholders	(19,301,675)	(12,429,181)
Accumulated net realized loss	(75,617,166)	(78,633,248)
Net unrealized depreciation	(22,898,073)	(49,293,563)
Treasury stock, at cost, 4,053,920 and 4,059,382 shares held, respectively	(33,191,298)	(33,236,788)
<b>Total shareholders' equity</b>	<b>223,396,267</b>	<b>198,739,000</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 306,049,791</b>	<b>\$ 201,379,278</b>
<b>Net asset value per share</b>	<b>\$ 11.70</b>	<b>\$ 10.41</b>

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**MVC Capital, Inc.****Consolidated Statements of Operations**

	<b>For the Period Ended November 1, 2005 to July 31, 2006</b>	<b>For the Period Ended November 1, 2004 to July 31, 2005</b>
	<b>(Unaudited)</b>	
<b>Operating Income:</b>		
Dividend income		
Affiliate investments	\$ 36,364	\$ 1,009,146
Control investments	88,525	
Total dividend income	124,889	1,009,146
Interest income (net of foreign taxes withheld of \$18,433 and \$0, respectively)		
Non-control/Non-affiliated investments	4,940,336	3,448,233
Affiliate investments	1,448,213	645,370
Control investments	2,768,553	1,483,008
Total interest income	9,157,102	5,576,611
Fee income		
Non-control/Non-affiliated investments	992,473	194,714
Affiliate investments	291,982	173,444
Control investments	1,381,625	1,028,303
Total fee income	2,666,080	1,396,461
Other income	455,713	856,318
<b>Total operating income</b>	<b>12,403,784</b>	<b>8,838,536</b>
<b>Operating Expenses:</b>		
Employee compensation and benefits	2,242,005	1,619,238
Incentive compensation (Note 8)	4,717,061	797,328
Insurance	354,211	460,773
Legal fees	438,669	426,501
Facilities	486,302	312,762
Other expenses	285,458	368,452
Audit fees	286,788	214,569
Consulting fees	282,641	145,939
Directors fees	156,501	106,275

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Administration	140,342	99,197
Public relations fees	61,600	98,746
Printing and postage	67,325	53,661
Interest, fees and other borrowing costs	683,590	20,415
<b>Total operating expenses</b>	<b>10,202,493</b>	<b>4,723,856</b>
<b>Net operating income before taxes</b>	<b>2,201,291</b>	<b>4,114,680</b>
<b>Tax (Benefit) Expenses:</b>		
Deferred tax expense (benefit)	(132,329)	(228,559)
Current tax expense	274,962	160,064
<b>Total tax (benefit) expense</b>	<b>142,633</b>	<b>(68,495)</b>
<b>Net operating income</b>	<b>2,058,658</b>	<b>4,183,175</b>
<b>Net Realized and Unrealized Gain (Loss) on Investments:</b>		
Net realized gain (loss) on investments		
Non-control/Non-affiliated investments	(147,640)	(7,264,505)
Affiliate investments	3,163,722	(1,000,000)
Net realized gain (loss) on foreign currency		(18,687)
Total net realized gain (loss) on investments	3,016,082	(8,283,192)
Net change in unrealized appreciation on investments	26,395,490	21,435,178
Net realized and unrealized gain on investments	29,411,572	13,151,986
<b>Net increase in net assets resulting from operations</b>	<b>\$ 31,470,230</b>	<b>\$ 17,335,161</b>
<b>Net increase in net assets per share resulting from operations</b>	<b>\$ 1.65</b>	<b>\$ 0.99</b>
<b>Dividends declared per share</b>	<b>\$ 0.36</b>	<b>\$ 0.12</b>

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**MVC Capital, Inc.****Consolidated Statements of Operations**

	<b>For the Quarter Ended May 1, 2006 to July 31, 2006</b>	<b>For the Quarter Ended May 1, 2005 to July 31, 2005</b>
	<b>(Unaudited)</b>	
<b>Operating Income:</b>		
Dividend income		
Affiliate investments	\$	\$ 333,446
Control investments	44,020	
Total dividend income	44,020	333,446
Interest income (net of foreign taxes withheld of \$0 and \$0, respectively)		
Non-control/Non-affiliated investments	1,871,510	1,605,577
Affiliate investments	591,741	219,910
Control investments	886,477	582,745
Total interest income	3,349,728	2,408,232
Fee income		
Non-control/Non-affiliated investments	215,579	107,876
Affiliate investments	147,141	66,363
Control investments	709,608	914,947
Total fee income	1,072,328	1,089,186
Other income	140,517	573,207
<b>Total operating income</b>	<b>4,606,593</b>	<b>4,404,071</b>
<b>Operating Expenses:</b>		
Employee compensation and benefits	844,615	633,512
Incentive compensation (Note 8)	1,160,875	402,800
Insurance	114,000	130,364
Legal fees	188,667	146,531
Facilities	153,488	139,324
Other expenses	55,484	144,625
Audit fees	99,966	90,804
Consulting fees	58,845	41,454
Directors fees	60,000	24,748



Administration	52,686	36,296
Public relations fees	18,400	33,304
Printing and postage	29,975	18,124
Interest, fees and other borrowing costs	635,817	8,056
<b>Total operating expenses</b>	<b>3,472,818</b>	<b>1,849,942</b>
<b>Net operating income before taxes</b>	<b>1,133,775</b>	<b>2,554,129</b>
<b>Tax (Benefit) Expenses:</b>		
Deferred tax (benefit) expense	(198,219)	(85,350)
Current tax (benefit) expense	259,892	159,739
<b>Total tax (benefit) expense</b>	<b>61,673</b>	<b>74,389</b>
<b>Net operating income</b>	<b>1,072,102</b>	<b>2,479,740</b>
<b>Net Realized and Unrealized Gain (Loss) on Investments:</b>		
Net realized gain (loss) on investments		
Non-control/Non-affiliated investments	(19,135)	(26,161)
Affiliate investments	5,463,722	
Net realized gain (loss) on foreign currency		
Total net realized gain (loss) on investments	5,444,587	(26,161)
Net change in unrealized appreciation on investments	1,529,345	7,856,948
Net realized and unrealized gain on investments	6,973,932	7,830,787
<b>Net increase in net assets resulting from operations</b>	<b>\$ 8,046,034</b>	<b>\$ 10,310,527</b>
<b>Net increase in net assets per share resulting from operations</b>	<b>\$ 0.42</b>	<b>\$ 0.58</b>
<b>Dividends declared per share</b>	<b>\$ 0.12</b>	<b>\$ 0.12</b>

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**MVC Capital, Inc.****Consolidated Statements of Cash Flows**

	<b>For the Period Ended November 1, 2005 to July 31, 2006</b>	<b>For the Period Ended November 1, 2004 to July 31, 2005</b>
		<b>(Unaudited)</b>
<b>Cash flows from operating activities:</b>		
Net increase in net assets resulting from operations	\$ 31,470,230	\$ 17,335,161
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided (used) by operating activities:		
Realized (gain) loss	(3,016,082)	8,283,192
Net change in unrealized (appreciation) depreciation	(26,395,490)	(21,435,178)
Amortization of discounts and fees	(166,926)	
Increase in accrued payment-in-kind dividends and interest	(1,375,226)	(969,023)
Increase in allocation of flow through income	(200,038)	(142,141)
Changes in assets and liabilities:		
Dividends, interest and fees receivable	(156,521)	(380,905)
Prepaid expenses	(1,995,432)	(275,724)
Prepaid taxes	56,854	
Deferred taxes	(132,329)	(228,559)
Deposits	(205,000)	
Other assets	25,353	(51,055)
Payable for investment purchased	(79,708)	
Liabilities	5,092,954	1,151,813
Purchases of equity investments	(24,043,834)	(17,315,000)
Purchases of debt instruments	(70,593,329)	(36,977,408)
Purchases of short term investments	(361,234,430)	(291,238,444)
Proceeds from equity investments	8,316,719	8,295,018
Proceeds from debt instruments	26,413,284	9,750,277
Sales/maturities of short term investments	334,203,912	288,330,546
<b>Net cash used by operating activities</b>	<b>(84,015,039)</b>	<b>(35,867,430)</b>
<b>Cash flows from financing activities:</b>		
Issuance of common stock		60,478,127
Distributions to shareholders paid	(6,812,963)	(2,290,289)
Net borrowings under term loan	30,000,000	
Net borrowings under revolving line of credit	45,000,000	3,975,000

<b>Net cash provided by financing activities</b>	68,187,037	62,162,838
<b>Net change in cash and cash equivalents for the period</b>	(15,828,002)	26,295,408
<b>Cash and cash equivalents, beginning of period</b>	26,297,190	13,146,941
<b>Cash and cash equivalents, end of period</b>	\$ 10,469,188	\$ 39,442,349

During the nine months ended July 31, 2006 and 2005, MVC Capital, Inc. paid \$359,487 and \$14,831 in interest expense, respectively.

During the nine months ended July 31, 2006 and 2005, MVC Capital, Inc. paid \$217,204 and \$207,299 in income taxes, respectively.

The accompanying notes are an integral part of these consolidated financial statements.

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**Non-cash activity:**

During the nine months ended July 31, 2006 and 2005, MVC Capital, Inc. recorded payment in kind dividend and interest of \$1,375,226 and \$969,023, respectively. This amount was added to the principal balance of the investments and recorded as interest/dividend income. These increases were approved by the Fund's Valuation Committee.

During the nine months ended July 31, 2006 and 2005, MVC Capital, Inc. was allocated \$348,320 and \$248,065, respectively, in flow-through income from its equity investment in Octagon Credit Investors, LLC. Of this amount, \$148,282 and \$105,924, respectively, was received in cash and the balance of \$200,038 and \$142,141, respectively, was undistributed and therefore increased the cost of the investment. The fair value was then retroactively increased by the Fund's Valuation Committee.

On August 3, 2005, MVC Capital, Inc. re-issued 826 shares of treasury stock, in lieu of a cash distribution totaling \$8,317, in accordance with the Fund's dividend reinvestment plan.

On November 2, 2005, MVC Capital, Inc. re-issued 1,904 shares of treasury stock, in lieu of a cash distribution totaling \$19,818, in accordance with the Fund's dividend reinvestment plan.

On February 1, 2006, MVC Capital, Inc. re-issued 1,824 shares of treasury stock, in lieu of a cash distribution totaling \$19,953, in accordance with the Fund's dividend reinvestment plan.

On May 1, 2006, MVC Capital, Inc. re-issued 1,734 shares of treasury stock, in lieu of a cash distribution totaling \$19,761, in accordance with the Fund's dividend reinvestment plan.

On December 27, 2005, MVC Capital, Inc. exchanged \$286,200 from the Timberland Machines & Irrigation, Inc.'s junior revolving line of credit for 29 shares of its common stock.

On December 31, 2005, MVC Capital, Inc. exercised its ProcessClaims, Inc. warrants for 373,362 shares of preferred stock.

On January 3, 2006, MVC Capital, Inc. exercised its warrant in Octagon Credit Investors, LLC. After the warrant was exercised, MVC Capital's ownership increased. As a result, Octagon is now considered an affiliate as defined in the Investment Company Act of 1940. See Note 3 to the financial statements for further information regarding Investment Classification.

On April 28, 2006, MVC Capital, Inc. increased the availability under the SGDA Sanierungsgesellschaft für Deponien und Altlasten (SGDA) revolving credit facility by \$300,000. The SGDA bridge note for \$300,000 was added to the revolving credit facility and the bridge loan was removed from MVC Capital's books as part of the refinancing.

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**MVC Capital, Inc.****Consolidated Statements of Changes in Net Assets**

	<b>For the Period Ended November 1, 2005 to July 31, 2006 (Unaudited)</b>	<b>For the Period Ended November 1, 2004 to July 31, 2005 (Unaudited)</b>	<b>For the Year Ended October 31, 2005</b>
<b>Operations:</b>			
Net operating income	\$ 2,058,658	\$ 4,183,175	\$ 5,795,368
Net realized gain (loss)	3,016,082	(8,283,192)	(3,295,550)
Net change in unrealized appreciation	26,395,490	21,435,178	23,768,366
<b>Net increase in net assets from operations</b>	<b>31,470,230</b>	<b>17,335,161</b>	<b>26,268,184</b>
<b>Shareholder Distributions:</b>			
Distributions to shareholders	(6,872,494)	(2,290,289)	(4,580,676)
<b>Net decrease in net assets from shareholder distributions</b>	<b>(6,872,494)</b>	<b>(2,290,289)</b>	<b>(4,580,676)</b>
<b>Capital Share Transactions:</b>			
Issuance of common stock		60,478,127	60,478,127
Reissuance of treasury stock to purchase investment		1,400,000	1,400,000
Offering expenses		(402,296)	(402,296)
Reissuance of treasury stock in lieu of cash dividend	59,531		8,317
<b>Net increase in net assets from capital share transactions</b>	<b>59,531</b>	<b>61,475,831</b>	<b>61,484,148</b>
<b>Total increase in net assets</b>	<b>24,657,267</b>	<b>76,520,703</b>	<b>83,171,656</b>
<b>Net assets, beginning of period</b>	<b>198,739,000</b>	<b>115,567,344</b>	<b>115,567,344</b>
<b>Net assets, end of period</b>	<b>\$ 223,396,267</b>	<b>\$ 192,088,047</b>	<b>\$ 198,739,000</b>
<b>Common shares outstanding, end of period</b>	<b>19,092,028</b>	<b>19,085,740</b>	<b>19,086,566</b>

The accompanying notes are an integral part of these consolidated financial statements.



Table of Contents**MVC Capital, Inc.****Consolidated Selected Per Share Data and Ratios**

	<b>For the Period Ended November 1, 2005</b>	<b>For the Period Ended November 1, 2004</b>	<b>For the Year Ended October 31, 2005</b>
	<b>to July 31, 2006 (Unaudited)</b>	<b>to July 31, 2005 (Unaudited)</b>	
Net asset value, beginning of period	\$ 10.41	\$ 9.40	\$ 9.40
Gain from operations:			
Net operating income	0.11	0.24	0.32
Net realized and unrealized gain on investments	1.54	0.75	1.13
Total gain from investment operations	1.65	0.99	1.45
Less distributions from:			
Income	(0.36)	(0.12)	(0.24)
Total distributions	(0.36)	(0.12)	(0.24)
Capital share transactions			
Dilutive effect of share issuance		(0.21)	(0.20)
Total capital share transactions		(0.21)	(0.20)
Net asset value, end of period	\$ 11.70	\$ 10.06	\$ 10.41
Market value, end of period	\$ 13.22	\$ 11.10	\$ 11.25
Market premium (discount)	12.99%	10.34%	8.07%
Total Return At NAV(a)	16.00%	8.30%	13.36%
Total Return At Market(a)	20.93%	21.43%	24.38%
<b>Ratios and Supplemental Data:</b>			
Net assets, end of period (in thousands)	\$ 223,396	\$ 192,088	\$ 198,739
Ratios to average net assets:			
Expenses excluding tax expense (benefit)	6.48%(b)	3.81%(b)	3.75%
Net operating income before tax expense (benefit)	1.40%(b)	3.31%(b)	3.28%
Expenses including tax expense (benefit)	6.57%(b)	3.75%(b)	3.69%
Net operating income after tax expense (benefit)	1.31%(b)	3.37%(b)	3.34%

- (a) Total annual return is historical and assumes changes in share price, reinvestments of all dividends and distributions, and no sales charge for the year.
- (b) Annualized.

The accompanying notes are an integral part of these consolidated financial statements.



Table of Contents**MVC Capital, Inc.****Consolidated Schedule of Investments****July 31, 2006**

<b>Company</b>	<b>Industry</b>	<b>Investment</b>	<b>Principal</b>	<b>Cost (Unaudited)</b>
<b>Non-affiliated 20.80%</b>				
arks, Inc.	Technology Investments	Preferred Stock (150,602 shares)(d)		\$ 5,000,003
rp.	Manufacturer of Precision Machined Components	Second Lien Seller Note 10.0000%, 06/29/2010(h)	\$ 2,473,521	2,473,521
		Second Lien Seller Note 16.0000%, 06/30/2013(b, h)	2,526,479	2,526,479
				5,000,000
LLC	Apparel	Second Lien Loan 14.0000%, 07/18/2012(b, h)	10,000,000	9,813,613
		Term Loan A 11.5000%, 07/18/2011(h)	3,000,000	2,944,120
		Term Loan B 13.6500%, 07/18/2011(h)	2,000,000	1,962,747
				14,720,480
	Technology Investments	Preferred Stock (602,131 shares)(d)		4,520,350
	Technology Investments	Preferred Stock (5,802,259 shares)(d)		15,000,000
armacy & Health	Healthcare Retail	Demand Note, 10.0000%(h)	200,000	200,000
y	Building Products/Specialty Chemicals	Term Loan A 8.8500%, 04/06/2011(h)	3,000,000	3,000,000
		Term Loan B 13.1000%, 04/06/2011(h)	2,000,000	2,000,000
				5,000,000
LLC	Electrical Distribution	Senior Subordinated Debt 17.0000%,	3,160,116	3,108,888

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ata		01/31/2009(b, h)		
		Common Stock		
Technologies PLC	Technology Investments	(5,786 shares)(d)		3,750,000
		Preferred Stock		
Inc.	Technology Investments	(2,106,378 shares)(d, e)		4,015,402
		Common Stock		
Inc.	Technology Investments	(131,615 shares)(d)		10,000,000
		Term Loan B		
	Laboratory Research Equipment	15.3500%,		
		03/31/2010(b, h)	4,051,080	3,992,460
		Senior Subordinated		
		Debt 17.0000%,		
		03/31/2012(b, h)	6,879,894	6,646,460
a, LLC				10,638,920
		Term Loan		
.S., Inc.	Self Storage	8.7500%, 03/30/2013(h)	1,330,250	1,336,871
		Term Loan A		
	Engineering Services	9.8500%, 12/31/2010(h)	4,954,128	4,954,128
		Term Loan B		
		13.8500%,		
		12/31/2010(h)	990,826	990,826
Non-affiliated				
				5,944,954
				<b>88,235,868</b>
Investments 31.45%				
rs Pasta		Common Stock		
	Manufacturer of Packaged Foods	(1,081,195 shares)		5,879,242
tems, Inc.		Preferred Stock		
	Technology Investments	(7,156,760 shares)(d)		7,000,000

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**MVC Capital, Inc.****Consolidated Schedule of Investments (Continued)**

<b>Company</b>	<b>Industry</b>	<b>Investment</b>	<b>Principal</b>	<b>Cost (Unaudited)</b>	<b>Fa</b>
Confections, Inc.	Confections Manufacturing and Distribution	Senior Subordinated Debt 17.0000%, 07/30/2009(b, h)	\$ 5,406,796	\$ 5,325,379	\$
		Senior Subordinated Debt 9.3500%, 07/29/2008(h)	325,000	320,671	
		Common Stock (252 shares)(d)		2,700,000	
				8,346,050	
hibition Corporation	Theme Park	Senior Subordinated Debt 11.0000%, 06/30/2013(b, h)	10,000,000	9,801,650	1
		Convertible Preferred Stock (2,000,000 shares)		2,000,000	
				11,801,650	1
edit Investors, LLC	Financial Services	Senior Subordinated Debt 15.0000%, 05/07/2011(b, h)	5,211,356	4,677,699	
		Limited Liability Company Interest		1,474,895	
				6,152,594	
al Corporation	Coal Processing and Production	Common Stock (1,666,667)(d)		1,000,000	
		Second Lien Note 15.0000%, 06/08/2011(b, h)	7,011,181	6,875,321	
				7,875,321	
nc.	Human Capital Management	Common Stock (9 shares)(d)		6,000,000	
odservice, Inc.	Non-Alcoholic Beverages	Common Stock (500,000 shares)(d)		5,000,000	
		Preferred Stock (1,000,000 shares)(b, h)		9,878,984	1

## Warrants(d)

14,878,984 2

**Affiliate Investments****67,933,841 7****Investments 42.74%**

ors Corporation

Automotive Dealership

Senior Subordinated  
Debt 10.0000%,  
06/24/2007(e, h)  
Common Stock  
(54,947 shares)(d, e)

4,500,000

4,500,000

6,000,000 1

cal Corporation

Medical Device Manufacturer

Common Stock  
(5,620 shares)(d)  
Revolving Line of  
Credit

10,500,000 1

17,000,000 2

erungsgesellschaft

Soil Remediation

7.0000%,  
08/25/2006(e, h)  
Term Loan

1,608,300

1,608,300

en und Altlasten

7.0000%,  
08/25/2009(e, h)  
Common Equity

4,579,050

4,363,825

Interest(d, e)

338,551

Preferred Equity  
Interest(d, e)

2,000,000

8,310,676

uto

Automotive Dealership

Common Stock  
(47,300 shares)(d, e)

8,000,000

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**MVC Capital, Inc.****Consolidated Schedule of Investments (Continued)**

<b>Company</b>	<b>Industry</b>	<b>Investment</b>	<b>Principal</b>	<b>Cost (Unaudited)</b>	
Machines & .	Distributor	Landscaping and Irrigation Equipment	Senior Subordinated Debt 14.4260%, 08/04/2009(b, h) Junior Revolving Line of Credit 12.5000%, 07/07/2007(h) Common Stock (479 shares)(d) Warrants(d)	\$ 6,533,750  2,963,800  4,786,200	\$ 6,472,142  2,963,800  4,786,200
					14,222,142
, LLC	Distributor	Landscaping and Irrigation Equipment	Senior Subordinated Debt 15.0000%, 11/30/2010(b, h) Limited Liability Company Interest(d) Warrants(d)	7,676,330	7,626,048 3,821,794
					11,447,842
es, Inc.	Technology Investments	Common Stock (10,476 shares)(d) Preferred Stock (6,443,188 shares)(d)		5,500,000 1,134,001	
				6,634,001	
acturing nc.	Iron Foundries	Senior Subordinated Debt 12.0000%, 04/29/2011(h) Common Stock (81,000 shares)(d)	900,000	900,000 1,850,000	
				2,750,000	
V	Renewable Energy	Common Equity Interest(e)		66,290	
<b>ntrol Investments</b>					<b>78,930,951</b>

## Short Term

## Investments

46%

(i)

Federal Home Loan

Bank Discount Note

U.S. Treasury Bills

U.S. Government &amp; Agency Securities

U.S. Government &amp; Agency Securities

4.8000%, 08/01/2006

4.6000%, 08/17/2006

4.8100%, 10/26/2006

45,006,000

11,000,000

23,500,000

45,006,000

10,977,462

23,229,972

34,207,434

79,213,434

45,006,000

10,977,462

23,229,972

34,207,434

79,213,434

## b Total Short

## Term Investments

## TOTAL

## INVESTMENT

## SETS

0.45% (f)

\$ 314,314,094 \$ 291,416,020

- (a) These securities are restricted from public sale without prior registration under the Securities Act of 1933. The Fund negotiates certain aspects of the method and timing of the disposition of these investments, including registration rights and related costs.
- (b) These securities accrue a portion of their interest/dividends in payment in kind interest/dividends which is capitalized to the investment.
- (c) All of the Fund's equity and debt investments are issued by eligible portfolio companies, as defined in the Investment Company Act of 1940, except Baltic Motors Corporation, Safestone Technologies PLC, SGDA Sanierungsgesellschaft für Deponien und Altlasten, SIA BM Auto and Velocitius B.V. The Fund makes available significant managerial assistance to all of the portfolio companies in which it has invested.
- (d) Non-income producing assets.
- (e) The principal operations of these portfolio companies are located outside of the United States.
- (f) Percentages are based on net assets of \$223,396,267 as of July 31, 2006.
- (g) See Note 3 to the financial statements for further information regarding Investment Classification.
- (h) All or a portion of these securities have been committed as collateral for the Guggenheim Corporate Funding, LLC Credit Facility.

Denotes zero cost/fair value.

The accompanying notes are an integral part of these consolidated financial statements.

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**MVC Capital, Inc.**  
**Consolidated Schedule of Investments**  
**October 31, 2005**

Company	Industry	Investment	Principal	Cost	Fair Value
<b>Non-control/Non-affiliated investments 16.95% (a, c, g, h)</b>					
Actelis Networks, Inc.	Technology Investments	Preferred Stock (150,602 shares) (d)		\$ 5,000,003	\$
Amersham Corp.	Manufacturer of Precision-Machined Components	Second Lien Seller Note 10.0000%, 06/29/2010	\$ 2,473,521	2,473,521	2,473,521
BP Clothing, LLC	Apparel	Second Lien Loan 11.8406%, 06/02/2009	9,166,667	8,998,430	9,166,667
DPHI, Inc.	Technology Investments	Preferred Stock (602,131 shares) (d)		4,520,350	
FOLIO <sup>fn</sup> , Inc.	Technology Investments	Preferred Stock (5,802,259 shares) (d)		15,000,000	
Integral Development Corporation	Technology Investments	Convertible Credit Facility 11.7500%, 12/31/2005(e)	1,122,216	1,121,520	1,122,216
JDC Lighting, LLC	Electrical Distribution	Senior Subordinated Debt 17.0000%, 01/31/2009(b)	3,090,384	3,025,871	3,090,384
Lumeta Corporation	Technology Investments	Preferred Stock (384,615 shares) (d)		250,000	43,511
		Preferred Stock (266,846 shares) (d)		156,489	156,489
				406,489	200,000

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MainStream Data	Technology Investments	Common Stock (5,786 shares) (d)		3,750,000	
Octagon Credit Investors, LLC	Financial Services	Senior Subordinated Debt 15.0000%, 05/07/2011(b)	5,145,912	4,560,740	4,664,794
		Limited Liability Company Interest		724,857	1,228,038
		Warrants (d)		550,000	1,069,457
				5,835,597	6,962,289
SafeStone Technologies PLC	Technology Investments	Preferred Stock (2,106,378 shares) (d, f)		4,015,402	
Sonexis, Inc.	Technology Investments	Common Stock (131,615 shares) (d)		10,000,000	
SP Industries, Inc.	Laboratory Research Equipment	Term Loan B 13.8406%, 03/31/2010(b)	4,020,488	3,947,304	4,020,488
		Senior Subordinated Debt 17.0000%, 03/31/2012(b)	6,650,360	6,401,062	6,650,360
				10,348,366	10,670,848
<b>Sub Total Non-control/Non affiliated investments</b>				<b>74,495,549</b>	<b>33,685,925</b>
<b>Affiliate investments 16.29% (a, c, g, h)</b>					
Dakota Growers Pasta Company, Inc.	Manufacturer of Packaged Foods	Common Stock (909,091 shares) (d)		5,000,000	5,514,000
Endymion Systems, Inc.	Technology Investments	Preferred Stock (7,156,760 shares) (d)		7,000,000	
Impact Confections, Inc.	Confections Manufacturing and Distribution	Senior Subordinated Debt 17.0000%,	5,228,826	5,133,069	5,228,826



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		07/30/2009(b) Senior Subordinated Debt 7.8406%, 07/29/2008	325,000	318,986	325,000
		Common Stock (252 shares) (d)		2,700,000	2,700,000
				8,152,055	8,253,826
ProcessClaims, Inc.	Technology Investments	Preferred Stock (6,250,000 shares) (d)		2,000,000	2,000,000
		Preferred Stock (849,257 shares) (d)		400,000	400,000
		Preferred Stock Warrants (d)		20	
				2,400,020	2,400,000
Vitality Foodservice, Inc.	Non-Alcoholic Beverages	Common Stock (500,000 shares) (d)		5,000,000	5,000,000
		Preferred Stock (1,000,000 shares) (b)		10,517,984	10,517,984
		Warrants (d)			700,000
				15,517,984	16,217,984
Yaga, Inc.	Technology Investments	Preferred Stock (300,000 shares) (d)		300,000	
		Preferred Stock (1,000,000 shares) (d)		2,000,000	
				2,300,000	
<b>Sub Total Affiliate investments</b>				<b>40,370,059</b>	<b>32,385,810</b>

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**MVC Capital, Inc.****Consolidated Schedule of Investments (Continued)**

<b>Company</b>	<b>Industry</b>	<b>Investment</b>	<b>Principal</b>	<b>Cost</b>	<b>Fair Value</b>
<b>Control investments 28.30%</b> <b>(c, g, h)</b>					
Altic Motors Corporation	Automotive Dealership	Senior Subordinated Debt 10.0000%, 06/24/2007(f) Common Stock (54,947 shares) (d, f)	\$ 4,500,000	\$ 4,500,000 6,000,000 10,500,000	\$ 4,500,000 7,500,000 12,000,000
bio Medical Corporation	Medical Device Manufacturer	Common Stock (5,620 shares) (d)		17,000,000	17,000,000
DA Sanierungsgesellschaft	Soil Remediation	Revolving Line of Credit 7.0000%, 08/25/2006(f)	1,237,700	1,237,700	1,237,700
r Deponien und Altlasten		Term Loan 7.0000%, 08/25/2009(f) Equity Interest (f)	4,579,050	4,304,560 315,000 5,857,260	4,304,560 315,000 5,857,260
umberland Machines & igation, Inc.	Distributor and Landscaping	Senior Subordinated Debt 17.0000%, 08/04/2009(b) Junior Revolving Line of Credit 12.5000%, 07/07/2007	6,318,684	6,234,373	6,318,684
	Irrigation Equipment	Common Stock (450 shares) (d) Warrants (d)	3,250,000	3,250,000 4,500,000 13,984,373	3,250,000 4,500,000 14,068,684
endio Services, Inc.	Technology Investments	Common Stock (10,476 shares) (d) Preferred Stock (6,443,188 shares) (d)		5,500,000 1,134,001 6,634,001	2,700,000 2,700,000
estal Manufacturing terprises, Inc.	Iron Foundries	Senior Subordinated Debt 12.0000%, 04/29/2011 Common Stock (81,000 shares) (d)	900,000	900,000 1,850,000	900,000 3,700,000

				2,750,000	4,600,000
<b>Sub Total Control Investments</b>				<b>56,725,634</b>	<b>56,225,940</b>
<b>Short Term Investments</b>					<b>Market Value</b>
<b>0.67% (g)</b>					
U.S. Treasury Bills	U.S. Government & Agency Securities	3.4400%, 12/01/2005	14,600,000	14,560,162	14,560,162
		3.2200%, 12/29/2005	9,865,000	9,812,368	9,812,368
		3.6300%, 01/12/2006	14,856,000	14,750,225	14,750,225
		3.4300%, 01/19/2006	12,000,000	11,904,147	11,904,147
				51,026,902	51,026,902
<b>Sub Total Short Term Investments</b>				<b>51,026,902</b>	<b>51,026,902</b>
<b>TOTAL INVESTMENT ASSETS 87.21% (g)</b>				<b>\$ 222,618,144</b>	<b>173,324,580</b>

- (a) These securities are restricted from public sale without prior registration under the Securities Act of 1933. The Fund negotiates certain aspects of the method and timing of the disposition of these investments, including registration rights and related costs.
- (b) These securities accrue a portion of their interest/dividends in payment in kind interest/dividends which is capitalized to the investment.
- (c) All of the Fund's equity and debt investments are issued by eligible portfolio companies, as defined in the Investment Company Act of 1940, except Baltic Motors Corporation, Safestone Technologies PLC and SGDA Sanierungsgesellschaft für Deponien und Altlasten. The Fund makes available significant managerial assistance to all of the portfolio companies in which it has invested.
- (d) Non-income producing assets.
- (e) Includes warrants to purchase a number of shares of preferred stock to be determined upon exercise.
- (f) The principal operations of these portfolio companies are located outside of the United States.
- (g) Percentages are based on net assets of \$198,739,000 as of October 31, 2005.
- (h) See Note 3 to the financial statements for further information regarding Investment Classification.

Denotes zero cost/fair value.

The accompanying notes are an integral part of these consolidated financial statements.

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**MVC Capital, Inc. (the Fund )**

**Notes to Consolidated Financial Statements**

**July 31, 2006  
(Unaudited)**

**1. Basis of Presentation**

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by generally accepted accounting principles for complete consolidated financial statements. Certain amounts have been reclassified to adjust to current period presentations. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These statements should be read in conjunction with the financial statements and notes thereto included in the Fund's Annual Report on Form 10-K for the year ended October 31, 2005, as filed with the United States Securities and Exchange Commission (the SEC) on December 22, 2005 (File No. 814-00201).

**2. Consolidation**

On July 16, 2004, the Fund formed a wholly-owned subsidiary, MVC Financial Services, Inc. ( MVCFS ). MVCFS is incorporated in Delaware and its principal purpose is to provide advisory, administrative and other services to the Fund, the Fund's portfolio companies and other entities. Under regulations governing the content of the Fund's financial statements, the Fund is generally precluded from consolidating any entity other than another investment company; however, an exception to these regulations allows the Fund to consolidate MVCFS since it is a wholly-owned operating subsidiary. MVCFS had opening equity of \$1 (100 shares at \$0.01 per share). The Fund does not hold MVCFS for investment purposes and does not intend to sell MVCFS. All intercompany accounts have been eliminated in consolidation.

**3. Investment Classification**

As required by the 1940 Act, we classify our investments by level of control. Control Investments are investments in those companies that we are deemed to Control, as defined by the 1940 Act. Affiliate Investments are investments in those companies that are Affiliated Companies of us, as defined by the 1940 Act, other than Control Investments.

Non-Control/Non-Affiliate Investments are those that are neither Control Investments nor Affiliate Investments. Generally, under the 1940 Act, we are deemed to control a company in which we have invested if we own 25% or more of the voting securities of such company or have greater than 50% representation on its board. We are deemed to be an affiliate of a company in which we have invested if we own 5% or more and less than 25% of the voting securities of such company.

**4. Concentration of Market Risk**

Financial instruments that subjected the Fund to concentrations of market risk consisted principally of equity investments, subordinated notes, and debt instruments (other than cash equivalents), which represent approximately 69.34% of the Fund's total assets at July 31, 2006. As discussed in Note 5, these investments consist of securities in companies with no readily determinable market values and as such are valued in accordance with the Fund's fair value policies and procedures. The Fund's investment strategy represents a high degree of business and financial risk due to the fact that the investments (other than cash equivalents) are generally illiquid, in small and middle market companies, and include entities with little operating history or entities that possess operations in new or developing

industries. These investments, should they become publicly traded, would generally be (i) subject to restrictions on resale, if they were acquired from the issuer in private placement transactions; and (ii) susceptible to market risk. At this time, the Fund's investments in short-term securities are in 90-day Treasury Bills, which are federally guaranteed securities, or other high quality, highly liquid investments. The Fund's cash balances, if not large enough to be invested in 90-day Treasury Bills or other high quality, highly liquid investments, are swept into designated money market accounts.

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**MVC Capital, Inc. (the Fund )**

**Notes to Consolidated Financial Statements (Continued)**

**5. Portfolio Investments**

**For the Nine Month Period Ended July 31, 2006**

During the nine month period ended July 31, 2006, the Fund made twelve new investments, committing capital totaling approximately \$91.9 million. The investments were made in Turf Products, LLC ( Turf ), Strategic Outsourcing, Inc. ( SOI ), Henry Company ( Henry ), SIA BM Auto ( BM Auto ), Storage Canada, LLC ( Storage Canada ), Phoenix Coal Corporation ( Phoenix ), Harmony Pharmacy & Health Center, Inc. ( Harmony Pharmacy ), Total Safety U.S., Inc. ( Total Safety ), PreVisor, Inc. ( PreVisor ), Marine Exhibition Corporation ( Marine ), BP Clothing LLC ( BP ), and Velocitius B.V. ( Velocitius ). The amounts invested were \$11.6 million, \$5.0 million, \$5.0 million, \$15.0 million, \$6.0 million, \$8.0 million, \$200,000, \$6.0 million, \$6.0 million, \$14.0 million, \$15.0 million, and \$66,290, respectively.

The Fund also made six follow-on investments in existing portfolio companies committing capital totaling approximately \$9.5 million. During the nine month period ended July 31, 2006, the Fund invested approximately \$879,000 in Dakota Growers Pasta Company, Inc. ( Dakota ) by purchasing an additional 172,104 shares of common stock at an average price of \$5.11 per share. On December 22, 2005, the Fund made a follow-on investment in Baltic Motors Corporation ( Baltic ) in the form of a \$1.8 million revolving bridge note. Baltic immediately drew down \$1.5 million from the note. On January 12, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The note matured on January 31, 2006 and has been removed from the Fund's books. On January 12, 2006, the Fund provided SGDA Sanierungsgesellschaft fur Deponien und Altasten mbH ( SGDA ) a \$300,000 bridge loan. On March 28, 2006, the Fund provided Baltic a \$2.0 million revolving bridge note. Baltic immediately drew down \$2.0 million from the note. On April 5, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The note matured on April 30, 2006 and has been removed from the Fund's books. On April 6, 2006, the Fund invested an additional \$2.0 million in SGDA in the form of a preferred equity security. On April 25, 2006, the Fund purchased an additional common equity security in SGDA for \$20,000. On June 30, 2006, the Fund invested \$2.5 million in Amersham Corporation ( Amersham ) in the form of a second lien loan.

At the beginning of the 2006 fiscal year, the revolving credit facility provided to SGDA had an outstanding balance of approximately \$1.2 million. During December 2005, SGDA drew down an additional \$70,600 from the credit facility. On April 28, 2006, the Fund increased the availability under the revolving credit facility by \$300,000. The balance of the bridge loan mentioned above, which would have matured on April 30, 2006, was added to the revolving credit facility and the bridge loan was eliminated from the Fund's books as a part of the refinancing. As of July 31, 2006, the entire \$1.6 million facility was drawn in full.

On December 21, 2005, Integral Development Corporation ( Integral ) prepaid its senior credit facility from the Fund in full. The Fund received approximately \$850,000 from the prepayment. This amount included all outstanding principal and accrued interest. The Fund recorded no gain or loss as a result of the prepayment. Under the terms of the prepayment, the Fund returned its warrants to Integral for no consideration.

Effective December 27, 2005, the Fund exchanged \$286,200, of the \$3.25 million outstanding, of the Timberland Machines & Irrigation, Inc. ( Timberland ) junior revolving line of credit into 28.62 shares of common stock at a price of \$10,000 per share. As a result, as of July 31, 2006, the Fund owned 478.62 common shares of Timberland and the

funded debt under the junior revolving line of credit was reduced from \$3.25 million to approximately \$2.96 million.

Effective December 31, 2005, the Fund received 373,362 shares of Series E preferred stock of ProcessClaims, Inc. ( ProcessClaims ) in exchange for its rights under a warrant issued by ProcessClaims that has been held by the Fund since May 2002. On January 5, 2006, the Valuation Committee of the Fund's board of directors ( Valuation Committee ) increased the fair value of the Fund's entire investment in ProcessClaims by \$3.3 million to \$5.7 million. Please see the paragraph below for more information on ProcessClaims.

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**MVC Capital, Inc. (the Fund )**

**Notes to Consolidated Financial Statements (Continued)**

On January 3, 2006, the Fund exercised its warrant ownership in Octagon Credit Investors, LLC ( Octagon ) which increased its existing membership interest. As a result, Octagon is now considered an affiliate of the Fund.

Due to the dissolution of Yaga, Inc. ( Yaga ), one of the Fund's legacy portfolio companies, the Fund realized losses on its investment in Yaga totaling \$2.3 million during the nine month period ended July 31, 2006. The Fund received no proceeds from the dissolution of Yaga and the Fund's investment in Yaga has been removed from the Fund's books. The Valuation Committee previously decreased the fair value of the Fund's investment in Yaga to zero and as a result, the Fund's realized losses were offset by reductions in unrealized losses. Therefore, the net effect of the removal of Yaga from the Fund's books on the Fund's consolidated statement of operations and NAV at July 31, 2006, was zero.

On February 24, 2006, BP repaid its second lien loan from the Fund in full. The amount of the proceeds received from the prepayment was approximately \$8.7 million. This amount included all outstanding principal, accrued interest, accrued monitoring fees and an early prepayment fee. The Fund recorded no gain or loss as a result of the repayment.

On April 7, 2006, the Fund sold its investment in Lumeta Corporation ( Lumeta ) for its carrying value of \$200,000. The Fund realized a loss on Lumeta of approximately \$200,000. However, the Valuation Committee previously decreased the fair value of the Fund's investment in Lumeta to \$200,000 and, as a result, the realized loss was offset by a reduction in unrealized losses. Therefore, the net effect of the Fund's sale of its investment in Lumeta on the Fund's consolidated statement of operations and NAV was zero.

On April 21, 2006, BM Auto repaid its bridge loan from the Fund in full. The amount of the proceeds received from the repayment was approximately \$7.2 million. This amount included all outstanding principal, accrued interest and was net of foreign taxes withheld. The Fund recorded no gain or loss as a result of the repayment.

On May 4, 2006, the Fund received a working capital adjustment of approximately \$250,000 related to the Fund's purchase of a membership interest in Turf. As a result, the Fund's cost basis in the investment was reduced by \$250,000.

On May 30, 2006, ProcessClaims, one of the Fund's legacy portfolio companies, entered into a definitive agreement to be acquired by CCC Information Services Inc. ( CCC ). The acquisition by CCC closed on June 9, 2006. As of June 9, 2006, the Fund received net proceeds of approximately \$7.9 million. The gross proceeds were approximately \$8.3 million of which approximately \$400,000 or 5% of the gross proceeds were deposited into a reserve account for one year. Due to the contingencies associated with the escrow, the Fund has not presently placed any value on the proceeds deposited in escrow and has therefore not factored such proceeds into the Fund's increased NAV. The Fund's total investment in ProcessClaims was \$2.4 million which resulted in a capital gain of approximately \$5.5 million.

On July 27, 2006, SOI repaid their loan from the Fund in full. The amount of the proceeds received from the prepayment was approximately \$4.5 million. This amount included all outstanding principal, accrued interest, and an early prepayment fee. The Fund recorded no gain or loss as a result of the prepayment.

During the nine month period ended July 31, 2006, the Valuation Committee increased the fair value of the Fund's investments in Baltic common stock by \$7.8 million, Dakota common stock by approximately \$1.1 million, Octagon's membership interest by approximately \$562,000, Ohio Medical Corporation ( Ohio ) common stock by \$9.2 million, ProcessClaims preferred stock by \$4.8 million and Vitality Foodservice, Inc. ( Vitality ) common stock and warrants by



\$3.5 million and \$400,000, respectively. In addition, increases recorded to the cost basis and fair value of the loans to Impact Confections, Inc. ( Impact ), JDC Lighting, LLC ( JDC ), Octagon, Phoenix, SP Industries, Inc. ( SP ), Timberland, Turf and the Vitality preferred stock were due to the receipt of payment in kind interest/dividends totaling approximately \$1.4 million. Also during the nine month period ended July 31, 2006, the undistributed allocation of flow through income from the Fund's equity investment in Octagon increased the cost

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**MVC Capital, Inc. (the Fund )**

**Notes to Consolidated Financial Statements (Continued)**

basis and fair value of the Fund's investment by approximately \$200,000. The increase in fair value from payment in kind interest/dividends and flow through income has been approved by the Fund's Valuation Committee.

At July 31, 2006, the fair value of all portfolio investments, exclusive of short-term securities, was \$212.2 million with a cost basis of \$235.1 million. At October 31, 2005, the fair value of all portfolio investments, exclusive of short-term securities, was \$122.3 million with a cost basis of \$171.6 million.

**For the Year Ended October 31, 2005**

During the year ended October 31, 2005, the Fund made six new investments, committing capital totaling approximately \$48.8 million. The investments were made in JDC, SGDA, SP, BP, Ohio and Amersham. The amounts invested were \$3.0 million, \$5.8 million, \$10.5 million, \$10 million, \$17 million and \$2.5 million, respectively.

The Fund also made three follow-on investments in existing portfolio companies committing capital totaling approximately \$5.0 million. In December 2004 and January 2005, the Fund invested a total of \$1.25 million in Timberland in the form of subordinated bridge notes. On April 15, 2005, the Fund re-issued 146,750 shares of its treasury stock at the Fund's NAV per share of \$9.54 in exchange for 40,500 shares of common stock of Vestal Manufacturing Enterprises, Inc. ( Vestal ). On July 8, 2005 the Fund extended Timberland a \$3.25 million junior revolving note. In accordance with the terms of the note, Timberland immediately drew \$1.3 million from the revolving note and used the proceeds to repay the subordinated bridge notes in full. The repayment included all outstanding principal and accrued interest. On July 29, 2005, the Fund invested an additional \$325,000 in Impact in the form of a secured promissory note.

In April 2005, Octagon drew \$1.5 million from the senior secured credit facility provided to it by the Fund and repaid it in full during June 2005.

During 2005, SGDA drew approximately \$1.2 million from the revolving credit facility provided to it by the Fund. As of October 31, 2005, the entire \$1.2 million drawn from the facility remained outstanding.

On July 14, 2005 and September 28, 2005, Timberland drew an additional \$1.5 million and \$425,000, from the revolving note mentioned above, respectively. As of October 31, 2005, the note was drawn in full and the balance of \$3.25 million remained outstanding.

Also, during the year ended October 31, 2005, the Fund sold its entire investment in Sygate Technologies, Inc. ( Sygate ) and received \$14.4 million in net proceeds. In addition, approximately \$1.6 million or 10% of proceeds from the sale were deposited in an escrow account for approximately one year. Due to the contingencies associated with the escrow, the Fund has not presently placed any value on the proceeds deposited in escrow and has therefore not factored such proceeds into the Fund's increased NAV. The realized gain from the \$14.4 million in net proceeds received was \$10.4 million. The Fund also sold 685,679 shares of Mentor Graphics Corp. ( Mentor Graphics ), receiving net proceeds of approximately \$9.0 million and realized a gain on the shares sold of approximately \$5.0 million. The Fund also received approximately \$300,000 from the escrow related to the 2004 sale of BlueStar Solutions, Inc. ( BlueStar ).

The Fund realized losses on CBCA, Inc. ( CBCA ) of approximately \$12.0 million, Phosistor Technologies, Inc. ( Phosistor ) of approximately \$1.0 million and ShopEaze Systems, Inc. ( ShopEaze ) of approximately \$6.0 million. The

Fund received no proceeds from these companies and they have been removed from the Fund's books. The Valuation Committee previously decreased the fair value of the Fund's investment in these companies to zero and as a result, the realized losses were offset by reductions in unrealized losses. Therefore, the net effect of the transactions on the Fund's consolidated statement of operations and NAV was zero.

On December 21, 2004, Determine Software, Inc. (Determine) prepaid its senior credit facility from the Fund in full. The amount of proceeds the Fund received from the repayment was approximately \$1.64 million. This

**Table of Contents****MVC Capital, Inc. (the Fund )****Notes to Consolidated Financial Statements (Continued)**

amount included all outstanding principal and accrued interest. Under the terms of the early repayment, the Fund returned its 2,229,955 Series C warrants for no consideration.

On July 5, 2005, Arcot Systems, Inc. ( Arcot ) prepaid its senior credit facility from the Fund in full. The amount of proceeds the Fund received from the repayment was approximately \$2.55 million. This amount included all outstanding principal and accrued interest. Under the terms of the early repayment, the Fund returned its warrants to Arcot for no consideration.

The Fund continued to receive principal repayments on the debt securities of Integral and BP. Integral made payments during the year ended October 31, 2005, according to its credit facility agreement totaling \$1,683,336. BP made two quarterly payments during the year ended totaling \$833,333. Also, the Fund received an early repayment of Vestal's debt securities totaling \$100,000.

During the year ended October 31, 2005, the Valuation Committee increased the fair value of the Fund's investments in Baltic by \$1.5 million, Dakota by \$514,000, Octagon by \$1,022,638, Sygate by \$7.5 million (which was later realized), Vendio Services, Inc. ( Vendio ) by \$1,565,999, Vestal by \$1,850,000 and Vitality by \$700,000. In addition, increases in the cost basis and fair value of the Octagon loan, Impact loan, Timberland loan, Vitality Series A preferred stock, JDC loan and SP loans were due to the receipt of payment in kind interest/dividends totaling \$1,370,777. Also during the year ended October 31, 2005, the undistributed allocation of flow through income from the Fund's equity investment in Octagon increased the cost basis and fair value of the investment by \$114,845. The increase in fair value from payment in kind interest/dividends and flow through income has been approved by the Fund's Valuation Committee.

At October 31, 2005, the fair value of all portfolio investments, exclusive of short-term securities, was \$122.3 million with a cost of \$171.6 million. At October 31, 2004, the fair value of all portfolio investments, exclusive of short-term securities, was \$78.5 million with a cost of \$151.6 million.

**6. Commitments and Contingencies*****Commitments to/for Portfolio Companies:*****Open Commitments of MVC Capital, Inc.**

<b>Portfolio Company</b>	<b>Amount Committed</b>	<b>Balance Outstanding at July 31, 2006</b>
Octagon	\$ 5.0 million	
SGDA	\$ 1.6 million	\$ 1.6 million
Timberland	\$ 3.25 million	\$ 2.96 million
Storage Canada	\$ 6.0 million	\$ 1.34 million
Marine	\$ 2.0 million	

On May 7, 2004, the Fund provided a \$5,000,000 senior secured credit facility to Octagon. This credit facility expires on May 6, 2007 and can be automatically extended until May 6, 2009. The credit facility bears annual interest at LIBOR plus 4%. The Fund receives a 0.50% unused facility fee on an annual basis and a 0.25% servicing fee on an annual basis for maintaining the credit facility. On February 1, 2006, Octagon drew \$250,000 from the credit facility. The credit facility was repaid in full including, all accrued interest on February 23, 2006. As of July 31, 2006, no borrowings were outstanding.

During February 2005, the Fund made available to SGDA, a \$1,308,300 revolving credit facility that bears annual interest at 7%. The credit facility expires on August 25, 2006. During fiscal year 2006, SGDA drew down \$70,600 from the credit facility. On April 28, 2006, the Fund increased the availability under the revolving credit facility by \$300,000. The balance of the Fund's bridge loan to SDGA, which would have matured on April 30, 2006,

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**MVC Capital, Inc. (the Fund )**

**Notes to Consolidated Financial Statements (Continued)**

was added to the revolving credit facility and the bridge loan was removed from the Fund's books. As of July 31, 2006, the entire \$1.6 million facility was drawn in full.

On July 8, 2005 the Fund extended Timberland a \$3.25 million junior revolving note that bears interest at 12.5% per annum and expires on July 7, 2007. The Fund also receives a fee of 0.25% on the unused portion of the note. As of October 31, 2005, the total amount outstanding on the note was \$3.25 million. On December 27, 2005, the Fund exchanged \$286,200 of the Timberland junior revolving line of credit for 28.62 shares of common stock at a price of \$10,000 per share. As a result, the Fund now owns 478.62 common shares and the funded debt under the junior revolving line of credit has been reduced from \$3.25 million to approximately \$2.96 million. On April 21, 2006, Timberland repaid \$500,000 on the note. On May 18, 2006, Timberland repaid an additional \$500,000 on the note. On July 10, 2006, Timberland drew down \$1.0 million leaving the total amount on the note outstanding at July 31, 2006 approximately \$2.96 million.

On June 30, 2005, the Fund pledged its common stock of Ohio to Guggenheim Corporate Funding, LLC ( Guggenheim ) to collateralize a loan made by Guggenheim to Ohio.

On December 22, 2005, the Fund extended to Baltic a \$1.8 million revolving bridge note. The note bears interest at 12% per annum and had a maturity date of January 31, 2006. Baltic immediately drew \$1.5 million from the note. On January 12, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The revolver ended on January 31, 2006 and has been removed from the Fund's books.

On March 28, 2006, the Fund extended to Baltic a \$2.0 million revolving bridge note. Baltic immediately drew down \$2.0 million from the note. On April 5, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The note matured on April 30, 2006 and has been removed from the Fund's books.

On March 30, 2006, the Fund provided a \$6 million loan commitment to Storage Canada. The company immediately borrowed \$1.34 million. The commitment expires after one year, but may be renewed with the consent of both parties. The initial borrowing on the loan bears annual interest at 8.75% and has a maturity date of March 30, 2013. Any additional borrowings will mature seven years from the date of the subsequent borrowing. The Fund also receives a fee of 0.25% on the unused portion of the loan.

On July 11, 2006, the Fund extended to Marine a \$2.0 million secured revolving note. The note bears annual interest at LIBOR plus 1%. The Fund also receives a fee of 0.50% of the unused portion of the loan. There was no amount drawn on the revolving note as of July 31, 2006.

Timberland also has a floor plan financing program administered by Transamerica Commercial Finance Corporation ( Transamerica ). As is typical in Timberland's industry, under the terms of the dealer financing arrangement, Timberland guarantees the repurchase of product from Transamerica, if a dealer defaults on payment and the underlying assets are repossessed. The Fund has agreed to be a limited co-guarantor for up to \$500,000 on this repurchase commitment.

***Commitments of the Fund:***

On October 28, 2004, the Fund entered into a one-year, cash collateralized, \$20 million revolving credit facility ( Credit Facility I ) with LaSalle Bank National Association (the Bank ). On July 20, 2005, the Fund amended Credit

Facility I. The maximum aggregate loan amount under Credit Facility I was increased from \$20 million to \$30 million. Additionally, the maturity date was extended from October 31, 2005 to August 31, 2006. All other material terms of Credit Facility I remained unchanged. On January 27, 2006, the Fund borrowed \$10 million under Credit Facility I. The \$10 million borrowed under Credit Facility I was repaid in full by February 3, 2006. Borrowings under Credit Facility I bear interest, at the Fund's option, at either a fixed rate equal to the LIBOR rate (for one, two, three or six months), plus 1.00% per annum, or at a floating rate equal to the Bank's prime rate in effect from time to time, minus 1.00% per annum. As of July 31, 2006, there were no borrowings outstanding under Credit Facility I.

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**MVC Capital, Inc. (the Fund )**

**Notes to Consolidated Financial Statements (Continued)**

On February 16, 2005, the Fund entered into a sublease (the Sublease ) for a larger space in the building in which the Fund's current executive offices are located. The Sublease is scheduled to expire on February 28, 2007. Future payments under the Sublease total approximately \$55,500 in fiscal year 2006 and \$75,000 in fiscal year 2007. The Fund's previous lease was terminated effective March 1, 2005, without penalty. The building in which the Fund's executive offices are located, 287 Bowman Avenue, is owned by Phoenix Capital Partners, LLC, an entity which is 97% owned by Mr. Tokarz. See Note 7 Management for more information on Mr. Tokarz.

On April 27, 2006, the Fund and MVCFS, as co-borrowers entered into a new four-year, \$100 million revolving credit facility ( Credit Facility II ) with Guggenheim as administrative agent to the lenders. On April 27, 2006, the Fund borrowed \$45 million (\$27.5 million drawn from the revolving credit facility and \$17.5 million in term debt) under Credit Facility II. The \$27.5 million drawn from the revolving credit facility was repaid in full on May 2, 2006. On July 28, 2006, the Fund borrowed \$57.5 million (\$45 million drawn from the revolving credit facility and \$12.5 million in term debt) under Credit Facility II. As of July 31, 2006, there was \$30 million in term debt and \$45 million on the revolving credit facility outstanding. The proceeds from borrowings made under Credit Facility II are expected to be used to fund new and existing portfolio investments, pay fees and expenses related to the financing and for general corporate purposes. Credit Facility II will expire on April 27, 2010, at which time all outstanding amounts under Credit Facility II will be due and payable. Borrowings under Credit Facility II will bear interest, at the Fund's option, at a floating rate equal to either (i) the LIBOR rate (for one, two, three or six months), plus 2.00% per annum, or (ii) the Prime rate in effect from time to time, plus 1.00% per annum. The Fund paid a closing fee, legal and other costs associated with this transaction. These costs will be amortized evenly over the life of the facility. The prepaid expenses on the Balance Sheet include the unamortized portion of these costs. Borrowings under Credit Facility II will be secured, by among other things, cash, cash equivalents, debt investments, accounts receivable, equipment, instruments, general intangibles, the capital stock of MVCFS and any proceeds from all the aforementioned items, as well as all other property except for equity investments made by the Fund.

The Fund enters into contracts with portfolio companies and other parties that contain a variety of indemnifications. The Fund's maximum exposure under these arrangements is unknown. However, the Fund has not experienced claims or losses pursuant to these contracts and believes the risk of loss related to indemnifications to be remote.

**7. Management**

On November 6, 2003, Michael Tokarz assumed his positions as Chairman, Portfolio Manager and Director of the Fund. As Portfolio Manager, Mr. Tokarz will be compensated by the Fund based upon his performance as the Portfolio Manager. Under the terms of his agreement with the Fund, the Fund will pay Mr. Tokarz incentive compensation in an amount equal to the lesser of (a) 20% of the net income of the Fund for the fiscal year; or (b) the sum of (i) 20% of the net capital gains realized by the Fund in respect of the investments made during his tenure as Portfolio Manager; and (ii) the amount, if any, by which the Fund's total expenses for a fiscal year were less than two percent of the Fund's net assets (determined as of the last day of the period). Any payments to be made shall be calculated based upon the audited financial statements of the Fund for the applicable fiscal year and shall be paid as soon as practicable following the completion of such audit. Mr. Tokarz has determined to allocate a portion of the incentive compensation to certain employees of the Fund. On October 31, 2005, the Fund's board of directors and Mr. Tokarz agreed to extend the term of Mr. Tokarz's current agreement with the Fund for an additional year. For the year ended October 31, 2005, Mr. Tokarz received no cash or other compensation from the Fund pursuant to his



contract. Please see Note 8 Incentive Compensation for more information.

On February 20, 2006, Robert Everett resigned from the Fund's board of directors. Mr. Everett's resignation did not involve a disagreement with the Fund on any matter.

On February 23, 2006, in accordance with the recommendation of the Nominating/Corporate Governance/Strategy Committee of the Fund's board of directors, Mr. William E. Taylor was appointed to serve on the Fund's

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**MVC Capital, Inc. (the Fund )**

**Notes to Consolidated Financial Statements (Continued)**

board of directors. Mr. Taylor was also appointed to serve on the Audit Committee and Nominating/Corporate Governance/Strategy Committee of the Fund's board of directors.

On May 30, 2006, the Fund's board of directors, including all of the Independent Directors (Mr. Tokarz recused himself from making a determination on this matter), unanimously approved a proposed Investment Advisory and Management Agreement between the Fund and The Tokarz Group Advisers, LLC (TTG Advisers ) (the Proposed Agreement ) which provides for the Fund to be managed externally by TTG Advisers, which is controlled exclusively by Mr. Tokarz. Implementation of the Proposed Agreement is subject to the approval of the Fund's shareholders. The Proposed Agreement is scheduled to be considered at the Fund's annual meeting of shareholders to be held on September 7, 2006. If the stockholders approve the Proposed Agreement at the meeting (or an adjournment thereof), the agreement would take effect on the later of: (i) November 1, 2006; or (ii) the effective date of the registration of TTG Advisers as an investment advisor with the SEC. A definitive proxy statement seeking, among other things, shareholder approval for the Proposed Agreement, was filed with the SEC on August 3, 2006.

**8. Incentive Compensation**

Under the terms of the Fund's agreement with Mr. Tokarz, as discussed in Note 7 Management, during the year ended October 31, 2005, the Fund created a provision for \$1,117,328 of estimated incentive compensation accounted for as a current expense. During the nine month period ended July 31, 2006, this provision was increased by \$4,717,061. The increase in the provision for incentive compensation resulted from the determination of the Valuation Committee to increase the fair value of five of the Fund's portfolio investments: Baltic, Dakota, Ohio, Octagon, and Vitality which are subject to the Fund's agreement with Mr. Tokarz, by a total of \$22,546,929. This reserve balance of \$5,834,389 will remain unpaid until net capital gains are realized, if ever, by the Fund. Pursuant to Mr. Tokarz's agreement with the Fund, only after a realization event may the incentive compensation be paid to him. Mr. Tokarz has determined to allocate a portion of the incentive compensation to certain employees of the Fund. During the year ended October 31, 2005 and the nine month period ended July 31, 2006, Mr. Tokarz was paid no cash or other compensation. Without this reserve for incentive compensation, operating expenses would have been approximately \$5.49 million instead of the \$10.20 million as reported in the Statement of Operations for the nine month period ended July 31, 2006. This would have resulted in net operating income of \$6.78 million instead of the \$2.06 million, as reported in the Statement of Operations for the nine month period ended July 31, 2006.

**9. Tax Matters**

On October 31, 2005, the Fund had a net capital loss carryforward of \$78,779,962 of which \$33,469,122 will expire in the year 2010, \$4,220,380 will expire in the year 2011, \$37,794,910 will expire in the year 2012 and \$3,295,550 will expire in the year 2013. To the extent future capital gains are offset by capital loss carryforwards, such gains need not be distributed.

**10. Dividends and Distributions to Shareholders**

As a regulated investment company ( RIC ) under Subchapter M of the Internal Revenue Code of 1986, as amended (the Code ), the Fund is required to distribute to its shareholders, in a timely manner, at least 90% of its investment company taxable and tax-exempt income each year. If the Fund distributes, in a calendar year, at least 98% of its ordinary income for such calendar year and its capital gain net income for the 12-month period ending on October 31

of such calendar year (as well as any portion of the respective 2% balances not distributed in the previous year), it will not be subject to the 4% non-deductible federal excise tax on certain undistributed income of RICs.

Dividends and capital gain distributions, if any, are recorded on the ex-dividend date. Dividends and capital gain distributions are generally declared and paid quarterly according to the Fund's policy established on July 11, 2005. An additional distribution may be paid by the Fund to avoid imposition of federal income tax on any remaining undistributed net investment income and capital gains. Distributions can be made payable by the Fund either in the form of a cash distribution or a stock dividend. The amount and character of income and capital gain

**Table of Contents****MVC Capital, Inc. (the Fund )****Notes to Consolidated Financial Statements (Continued)**

distributions are determined in accordance with income tax regulations which may differ from accounting principles generally accepted in the United States of America. These differences are due primarily to differing treatments of income and gain on various investment securities held by the Fund, timing differences and differing characterizations of distributions made by the Fund. Permanent book and tax basis differences relating to shareholder distributions will result in reclassifications and may affect the allocation between net operating income, net realized gain (loss) and paid in capital.

**For the Quarter Ended January 31, 2006**

On July 11, 2005, the Fund's board of directors announced that it has approved the Fund's establishment of a policy seeking to pay quarterly dividends to shareholders. On December 20, 2005, the Fund's board of directors declared a dividend of \$.12 per share payable on January 31, 2006 to shareholders of record on December 30, 2005. The ex-dividend date was December 28, 2005. The total distribution amounted to \$2,290,616 including distributions reinvested. In accordance with the Fund's dividend reinvestment plan (the Plan), Computershare Ltd. (f/k/a Equiserve), the Plan Agent, re-issued 1,904 shares of common stock from the Fund's treasury to shareholders participating in the Plan.

**For the Quarter Ended April 30, 2006**

On April 11, 2006, the Fund's board of directors declared a dividend of \$.12 per share payable on April 28, 2006 to shareholders of record on April 21, 2006. The ex-dividend date was April 19, 2006. The total distribution amounted to \$2,290,835 including distributions reinvested. In accordance with the Plan, the Plan Agent re-issued 1,733 shares of common stock from the Fund's treasury to shareholders participating in the Plan.

**For the Quarter Ended July 31, 2006**

On July 14, 2006, the Fund's board of directors declared a dividend of \$.12 per share payable on July 31, 2006 to shareholders of record on July 24, 2006. The ex-dividend date was July 20, 2006. The total distribution amounted to \$2,291,043 including distributions reinvested. In accordance with the Plan, the Plan Agent re-issued 1,901 shares of common stock from the Fund's treasury to shareholders participating in the Plan.

**11. Segment Data**

The Fund's reportable segments are its investing operations as a business development company and the financial advisory operations of its wholly-owned subsidiary, MVCFS.

The following table presents book basis segment data for the nine month period ended July 31, 2006:

	<b>MVC</b>	<b>MVCFS</b>	<b>Consolidated</b>
Interest and dividend income	\$ 9,188,223	\$ 93,768	\$ 9,281,991
Fee income	244,035	2,422,045	2,666,080
Other income	455,713		455,713

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Total operating income	9,887,971	2,515,813	12,403,784
Total operating expenses	9,868,248	334,245	10,202,493
Net operating income before taxes	19,723	2,181,568	2,201,291
Tax expense (benefit)		142,633	142,633
Net operating income	19,723	2,038,935	2,058,658
Net realized gain (loss) on investments and foreign currency	3,016,082		3,016,082
Net change in unrealized appreciation on investments	26,395,490		26,395,490
Net increase in net assets resulting from operations	\$ 29,431,295	\$ 2,038,935	\$ 31,470,230

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**MVC Capital, Inc. (the Fund )**

**Notes to Consolidated Financial Statements (Continued)**

In all periods prior to July 16, 2004, all business was conducted through MVC Capital, Inc.

**12. Legal Proceedings**

During the year ended October 31, 2003, the Fund paid or accrued \$4.0 million for legal and proxy solicitation fees and expenses, which included \$2.2 million accrued and paid at the direction of the Board of Directors, to reimburse the legal and proxy solicitation fees and expenses of two major Fund shareholders, Millenco, L.P. and Karpus Investment Management, including their costs of obtaining a judgment against the Fund in the Delaware Chancery Court and costs associated with the proxy process and the election of the current Board of Directors. The Fund made a claim against its insurance carrier, Federal Insurance Company ( Federal ) for its right to reimbursement of such expenses. On June 13, 2005, the Fund reached a settlement with Federal in the amount of \$473,968 which has been recorded as Other Income in the Consolidated Statement of Operations. Legal fees and expenses associated with reaching this settlement were \$47,171.

**13. Recovery of Expenses and Unusual Income Items**

During the year ended October 31, 2003, the Fund paid or accrued \$4.0 million for legal and proxy solicitation fees and expenses, which included \$2.2 million accrued and paid at the direction of the Board of Directors, to reimburse the legal and proxy solicitation fees and expenses of two major Fund shareholders, Millenco, L.P. and Karpus Investment Management, including their costs of obtaining a judgment against the Fund in the Delaware Chancery Court and costs associated with the proxy process and the election of the current Board of Directors. The Fund made a claim against its insurance carrier, Federal, for its right to reimbursement of such expenses. On June 13, 2005, the Fund reached a settlement with Federal in the amount of \$473,968 which has been recorded as Other Income in the Consolidated Statement of Operations. Legal fees and expenses associated with reaching this settlement were \$47,171.

**14. Subsequent Events**

On August 2, 2006, the Fund repaid the \$45.0 million borrowed on the revolving credit facility under Credit Facility II.

On August 7, 2006, the Fund made a follow on equity investment in Harmony Pharmacy, investing \$750,000 for 2 million shares of common stock. Harmony is an operator of pharmacy and healthcare centers primarily in airports in the United States.

On August 16, 2006, the Fund consummated a leveraged buyout of Summit Research Labs, Inc. ( Summit ) a Huguenot, NY based specialty chemical company that manufactures antiperspirant actives. The Fund's investment in Summit consists of \$11.2 million in equity and \$5.0 million second lien loan. The second lien loan bears annual interest at 14% and matures August 15, 2012.

On August 25, 2006, Harmony Pharmacy repaid their \$200,000 demand note in full including all accrued interest.

On August 25, 2006, SGDA's revolving credit facility of approximately \$1.6 million was added to the term loan with an outstanding balance of approximately \$4.6 million. The total outstanding balance of the term loan is now

approximately \$6.2 million. The line of credit was removed from the Fund's books as part of this transaction.

On August 31, 2006, the revolving credit facility with LaSalle Bank National Association, Credit Facility I, expired.

The Fund's annual meeting of shareholders is scheduled to be held on September 7, 2006. At the meeting, shareholders will be asked to: (i) elect five nominees to serve as members of the board of directors; and (ii) approve the Proposed Agreement. A definitive proxy statement relating to the meeting was filed with the SEC on August 3, 2006.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This report contains certain statements of a forward-looking nature relating to future events or the future financial performance of the Fund and its investment portfolio companies. Words such as *may*, *will*, *expect*, *believe*, *anticipate*, *intend*, *could*, *estimate*, *might* and *continue*, and the negative or other variations thereof or comparable terminology, are intended to identify forward-looking statements. Forward-looking statements are included in this report pursuant to the "Safe Harbor" provision of the Private Securities Litigation Reform Act of 1995. Such statements are predictions only, and the actual events or results may differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those relating to investment capital demand, pricing, market acceptance, the effect of economic conditions, litigation and the effect of regulatory proceedings, competitive forces, the results of financing and investing efforts, the ability to complete transactions and other risks identified below or in the Fund's filings with the SEC. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Fund undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events. The following analysis of the financial condition and results of operations of the Fund should be read in conjunction with the Financial Statements, the Notes thereto and the other financial information included elsewhere in this report.



**Table of Contents****SELECTED CONSOLIDATED FINANCIAL DATA:**

Financial information for the fiscal year ended October 31, 2005 is derived from the consolidated financial statements, which have been audited by Ernst & Young LLP, the Fund's independent registered public accountants. Quarterly financial information is derived from unaudited financial data, but in the opinion of management, reflects all adjustments (consisting only of normal recurring adjustments), which are necessary to present fairly the results for such interim periods.

**Selected Consolidated Financial Data**

	<b>Nine Month Period Ended July 31, 2006 (Unaudited)</b>	<b>Nine Month Period Ended July 31, 2005 (Unaudited)</b>	<b>Year Ended October 31, 2005</b>
<b>(In thousands, except per share data)</b>			
<b>Operating Data:</b>			
Interest and related portfolio income:			
Interest and dividend income	\$ 9,282	\$ 6,586	\$ 9,457
Fee income	2,666	1,396	1,809
Other income	456	856	933
Total operating income	12,404	8,838	12,199
Expenses:			
Employee	2,242	1,619	2,336
Incentive compensation (Note 8)	4,717	797	1,117
Administrative	3,244	2,307	3,052
Total operating expenses	10,203	4,723	6,505
Net operating income (loss) before taxes	2,201	4,115	5,694
Tax expense (benefit), net	143	(68)	(101)
Net operating income (loss)	2,058	4,183	5,795
Net realized and unrealized gains (losses):			
Net realized gains (losses)	3,016	(8,283)	(3,295)
Net change in unrealized appreciation (depreciation)	26,396	21,435	23,768
Net realized and unrealized gains (losses) on investments	29,412	13,152	20,473
Net increase (decrease) in net assets resulting from operations	\$ 31,470	\$ 17,335	\$ 26,268
<b>Per Share:</b>			
Net increase (decrease) in net assets per share resulting from operations	\$ 1.65	\$ 0.99	\$ 1.45

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Dividends per share	\$ 0.36	\$ 0.12	\$ 0.24
Balance Sheet Data:			
Portfolio at value	\$ 212,203	\$ 130,018	\$ 122,298
Portfolio at cost	235,101	181,645	171,591
Total assets	306,050	208,549	201,379
Shareholders' equity	223,396	192,088	198,707
Shareholders' equity per share (net asset value)	\$ 11.70	\$ 10.06	\$ 10.41
Common shares outstanding at period end	19,092	19,086	19,087
Other Data:			
Number of Investments funded in period	18	9	9
Investments funded (\$) in period	\$ 101,400	\$ 53,836	\$ 53,836

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	2006		2005				2004			
	Qtr 3	Qtr 2	Qtr 1	Qtr 4	Qtr 3	Qtr 2	Qtr 1	Qtr 4	Qtr 3 <sup>(1)</sup>	Qtr 2
<b>ata (Unaudited):</b>	<b>(In thousands except per share data)</b>									
g income	\$ 4,607	\$ 3,915	\$ 3,882	\$ 3,361	\$ 4,404	\$ 2,439	\$ 1,995	\$ 1,811	\$ 951	\$ 508
income (loss)										
alized and										
ns	1,072	156	830	1,612	2,480	821	882	665	281	(498)
(decrease) in net										
g from operations	8,046	11,117	12,307	8,933	10,310	4,360	2,665	3,274	4,922	1,104
(decrease) in net										
g from operations										
	0.42	0.58	0.65	0.46	0.58	0.23	0.18	0.27	0.41	0.09
e per share	11.70	11.40	10.94	10.41	10.06	9.64	9.41	9.40	9.25	8.85

(1) Data for 2004 differs from that which was filed on Form 10-Q on September 9, 2004, due to a reclassification of investment income and related expenses which had previously been accrued for.

**OVERVIEW**

The Fund is a non-diversified closed-end management investment company that has elected to be regulated as a business development company under the 1940 Act. The Fund's investment objective is to seek to maximize total return from capital appreciation and/or income.

On November 6, 2003, Mr. Tokarz assumed his positions as Chairman and Portfolio Manager of the Fund. Mr. Tokarz and the Fund's investment professionals are seeking to implement the Fund's investment objective (*i.e.*, to maximize total return from capital appreciation and/or income) through making a broad range of private investments in a variety of industries.

The investments can include senior or subordinated loans, convertible debt and convertible preferred securities, common or preferred stock, equity interests, warrants or rights to acquire equity interests, and other private equity transactions. In the year ended October 31, 2005, we made six new investments and three additional investments in existing portfolio companies, committing capital totaling approximately \$53.8 million. During the nine month period ended July 31, 2006, we made twelve new investments and six additional investments in existing portfolio companies, committing capital totaling approximately \$101.4 million.

Prior to the adoption of our current investment objective, the Fund's investment objective had been to achieve long-term capital appreciation from venture capital investments in information technology companies. The Fund's investments had thus previously focused on investments in equity and debt securities of information technology companies. As of July 31, 2006, 0.88% of the current fair value of our assets consisted of portfolio investments made by the Fund's former management team pursuant to the prior investment objective. We are, however, seeking to manage these remaining legacy investments to try and realize maximum returns. We generally seek to capitalize on opportunities to realize cash returns on these investments when presented with a potential liquidity event, *i.e.*, a sale, public offering, merger or other reorganization.

Our new portfolio investments are made pursuant to our current objective and strategy. We are concentrating our investment efforts on small and middle-market companies that, in our view, provide opportunities to maximize total

return from capital appreciation and/or income. Under our investment approach, we are permitted to invest, without limit, in any one portfolio company, subject to any diversification limits required in order for us to continue to qualify as a RIC under Subchapter M of the Code.

We participate in the private equity business generally by providing privately negotiated long-term equity and/or debt investment capital to small and middle-market companies. Our financing is generally used to fund growth, buyouts, acquisitions, recapitalizations, note purchases, and/or bridge financings. We generally invest in private companies, though, from time to time, we may invest in public companies that may lack adequate access to public capital.

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We may also seek to achieve our investment objective by establishing a subsidiary or subsidiaries that would serve as general partner or investment adviser to a private equity or other investment fund(s). Additionally, we may also acquire a portfolio of existing private equity or debt investments held by financial institutions or other investment funds.

### **OPERATING INCOME**

*For the Nine Month Periods Ended July 31, 2006 and 2005.* Total operating income was \$12.4 million for the nine month period ended July 31, 2006 and \$8.8 million for the nine month period ended July 31, 2005, an increase of \$3.6 million.

#### ***For the Nine Month Period Ended July 31, 2006***

Total operating income was \$12.4 million for the nine month period ended July 31, 2006. The increase in operating income over the same nine month period last year was primarily due to the increase in the number of investments that provide the Fund with current income. For the nine month periods ended July 31, 2006 and 2005, the Fund made 18 and 9 investments in portfolio companies, respectively. The main components of investment income were the interest and dividend income earned on loans to portfolio companies and the receipt of closing and monitoring fees from certain portfolio companies by the Fund and MVCFS. The Fund earned approximately \$7.3 million in interest and dividend income from investments in portfolio companies. Of the \$7.3 million recorded in interest/dividend income, approximately \$1.4 million was payment in kind interest/dividends. The payment in kind interest/dividends are computed at the contractual rate specified in each investment agreement and added to the principal balance of each investment. During the nine month period ended July 31, 2006, the Fund reclassified dividend income received from Vitality totaling approximately \$900,000 to return of capital. The reclassification occurred due to the determination that Vitality will not have taxable earnings and profits for their fiscal year 2006. This reclassification to return of capital had no impact on the Fund's net asset value. The Fund's investments yielded rates from 7% to 17%. Also, the Fund earned approximately \$2.0 million in interest income on its cash equivalents and short-term investments. The Fund received fee income and other income from portfolio companies and other entities totaling approximately \$2.7 million and \$455,713, respectively. Included in other income is flow through income from limited liability companies and cash received from the Mentor Graphics multi-year earnout. Please see the Fund's 2005 Annual Report on Form 10-K for more information regarding the Mentor Graphics earnout.

#### ***For the Nine Month Period Ended July 31, 2005***

Total operating income was \$8.8 million for the nine month period ended July 31, 2005. The increase in investment income over the same nine month period last year is due to the increase in the number of investments that provide the Fund with current income. The main components of investment income are the interest income earned on loans to portfolio companies and the receipt of closing and monitoring fees from certain portfolio companies by the Fund and MVCFS. The Fund earned approximately \$5.19 million in interest and dividend income from investments in portfolio companies. Of the \$5.19 million recorded in interest and dividend income, approximately \$969,000 was payment in kind interest/dividends. The payment in kind interest/dividends are computed at the contractual rate specified in each investment agreement and added to the principal balance of each investment. The Fund's yielding investments were paying interest and dividends to the Fund at various rates from 7% to 17%. Also, the Fund earned approximately \$1.4 million in interest income on its cash equivalents and short-term investments during the nine month period ended July 31, 2005. The Fund received fee income and other income from portfolio companies totaling approximately \$1.4 million and \$856,000, respectively. Included in other income is a legal settlement of \$473,968. See Note 12 Legal Proceedings for more information. Without the receipt of this settlement, other income earned for the nine months ended July 31, 2005, would have been \$382,350.

## **OPERATING EXPENSES**

*For the Nine Month Periods Ended July 31, 2006 and 2005.* Operating expenses were \$10.2 million for the nine month period ended July 31, 2006 and \$4.7 million for the nine month period ended July 31, 2005, an increase of \$5.5 million.

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***For the Nine Month Period Ended July 31, 2006***

Operating expenses were \$10.2 million or 6.48% of the Fund's average net assets, when annualized, for the nine month period ended July 31, 2006. Significant components of operating expenses for the nine month period ended July 31, 2006, included estimated provision for incentive compensation expense of approximately \$4.7 million, salaries and benefits of approximately \$2.2 million, insurance premium expenses of \$354,211, interest expense and other borrowing costs of \$683,590, legal fees of \$438,669 and facilities-related expenses of \$486,302. Estimated provision for incentive compensation expense is a non-cash, not yet payable, provisional expense relating to Mr. Tokarz's agreement with the Fund.

The \$5.5 million increase in the Fund's operating expenses in the nine month period ended July 31, 2006 compared to the nine month period ended July 31, 2005, was primarily due to the \$3.9 million increase in the provision for estimated incentive compensation. An increase in the number of employees needed to service the larger portfolio resulted in an increase of \$622,767 in salaries and benefits. Also, the Fund's rent and other facility related expenses increased approximately \$175,540 primarily due to the Fund's procurement of larger office space to accommodate the Fund's increased number of employees. See Note 6 Commitments and Contingencies for more information.

The increase of approximately \$662,175 in the Fund's interest expense and other borrowing costs in the nine month period ended July 31, 2006, was due to additional borrowings under the new Credit Facility II.

Pursuant to the terms of the Fund's agreement with Mr. Tokarz, during the nine month period ended July 31, 2006, the provision for estimated incentive compensation was increased by \$4,717,061. The increase in the provision for incentive compensation resulted from the determination of the Valuation Committee to increase the fair value of five of the Fund's portfolio investments: Baltic, Dakota, Ohio, Octagon, and Vitality which are subject to the Fund's agreement with Mr. Tokarz, by a total of \$22,546,929. This reserve balance of \$5,834,389 will remain unpaid until net capital gains are realized, if ever, by the Fund. Pursuant to Mr. Tokarz's agreement with the Fund, only after a realization event, may the incentive compensation be paid to him. Mr. Tokarz has determined to allocate a portion of his incentive compensation to certain employees of the Fund. During the year ended October 31, 2005 and the nine month period ended July 31, 2006, Mr. Tokarz was paid no cash or other compensation. Without this reserve for incentive compensation, operating expenses would have been approximately \$5.49 million or 3.48% of average net assets when annualized as compared to 6.48% which is reported on the Consolidated Per Share Data and Ratios, for the nine month period ended July 31, 2006. Please see Note 8 Incentive Compensation for more information.

In February 2006, the Fund renewed its Directors & Officers/Professional Liability Insurance policies at an expense of approximately \$459,000 which is amortized over the twelve month life of the policy. The prior policy premium was \$517,000.

***For the Nine Month Period Ended July 31, 2005***

Operating expenses were \$4.7 million for the nine month period ended July 31, 2005. Significant components of operating expenses for the nine month period ended July 31, 2005 include salaries and benefits of \$1,619,238, incentive compensation of \$797,328, insurance premium expenses of \$460,773, legal fees of \$426,501 and facilities related expenses of \$312,762.

The increase in the Fund's operating expenses comparing 2005 with 2004 was due to increases in certain variable expenses. The Fund's salaries and benefits expense increased due to the addition of several new employees. Also, the Fund's rent and other facility related expenses increased primarily due to the Fund's procurement of larger office space to accommodate the Fund's new employees. See Note 5 Commitments and Contingencies for more information.

Incentive compensation was first accrued in the nine month period ended July 31, 2005. This accrual of incentive compensation resulted from the determination of the Valuation Committee to increase the fair value of four of the Fund's portfolio investments: Baltic, Dakota, Octagon, and Vestal, which are subject to the Fund's agreement with Mr. Tokarz, by a total of \$3,986,638. This accrued balance of \$797,328 will remain unpaid until these potential net capital gains are realized, if ever, by the Fund. Only after a realization event, will the incentive



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compensative be paid under the agreement with Mr. Tokarz. Mr. Tokarz has determined to allocate a portion of the incentive compensation to certain employees of the Fund. During the nine month period ended July 31, 2005, Mr. Tokarz was paid no cash or other compensation. Please see Note 8 Incentive Compensation for more information.

In February 2005, the Fund renewed its Directors & Officers/Professional Liability Insurance policies at an expense of approximately \$517,000 which is amortized over the twelve month life of the policy. The prior policy premium was \$719,000.

During the nine month period ended July 31, 2005, the Fund paid or accrued \$426,501 in legal fees. Legal expenses included fees of \$47,171 incurred while pursuing a claim against Federal Insurance Company. See Note 12 Legal Proceedings for more information. The settlement from this legal action was \$473,968 which was recorded into other income. After fees and expenses, the cash received from the settlement was \$426,797. Without the legal fees related to the litigation, the Fund would have paid or accrued \$379,330 in legal fees.

## **REALIZED GAINS AND LOSSES ON PORTFOLIO SECURITIES**

*For the Nine Month Periods Ended July 31, 2006 and 2005.* Net realized gains for the nine month period ended July 31, 2006 were \$3.0 million and net realized losses for the nine month period ended July 31, 2005 were \$8.3 million, an increase of \$11.3 million.

### ***For the Nine Month Period Ended July 31, 2006***

Net realized gains for the nine month period ended July 31, 2006 were \$3.0 million. The significant component of the Fund's net realized gain for the nine month period ended July 31, 2006 was primarily due to the gain on the sale of Process Claims.

During the nine month period ended July 31, 2006, the Fund sold its investment in ProcessClaims and realized a gain of approximately \$5.5 million. The Fund was entitled to receive approximately \$8.3 million in gross proceeds, of which approximately \$400,000 or 5% of the proceeds will be deposited into a reserve account for one year. Due to the contingencies associated with the escrow, the Fund has not presently placed any value on the proceeds deposited in escrow and has therefore not factored such proceeds into the Fund's increased NAV. The Fund received net proceeds of approximately \$7.9 million.

The Fund received notification of the final dissolution of Yaga. The Fund received no proceeds from the dissolution of this company and the investment has been removed from the Fund's books. The Fund realized a loss of \$2.3 million as a result of this dissolution. The fair value of Yaga was previously written down to zero and therefore, the net effect of the removal of Yaga from the Fund's books on the Fund's consolidated statement of operations and NAV was zero.

On April 7, 2006, the Fund sold its investment in Lumeta for its carrying value of \$200,000. The Fund realized a loss on Lumeta of approximately \$200,000. However, the Valuation Committee previously decreased the fair value of the Fund's investment in this company to \$200,000 and as a result, the realized loss was offset by a reduction in unrealized losses. Therefore, the net effect of the Fund's sale of its investment in Lumeta on the Fund's consolidated statement of operations and NAV was zero.

The Fund also received a payout related to a former portfolio company, Annuncio, of approximately \$70,000.

### ***For the Nine Month Period Ended July 31, 2005***

## Edgar Filing: MVC CAPITAL, INC. - Form 10-Q

Net realized losses for the nine month period ended July 31, 2005 were \$8.3 million. The significant components of the Fund's net realized loss for the nine month period ended July 31, 2005 were a realized gain on the Fund's investment in Mentor Graphics which was offset by realized losses on CBCA and Phosistor.

During the nine months ended July 31, 2005, the Fund sold 603,396 shares of Mentor Graphics at an average price of \$13.75 per share and realized a gain on the shares sold of approximately \$4.8 million. The total net proceeds received from the shares sold were approximately \$8.3 million. At July 31, 2005 the 82,283 remaining shares of Mentor Graphics owned by the Fund were held in escrow and therefore restricted as to their resale. The Fund's

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Valuation Committee determined to carry the escrow shares at zero because they were unable to determine how many shares, if any, the Fund would receive from the escrow and the market value of the shares received.

The Fund realized losses on CBCA of approximately \$12 million and on Phosistor of approximately \$1 million. The Fund received no proceeds from these companies and they have been removed from the Fund's portfolio. The fair values of CBCA and Phosistor had been previously written down to zero and as a result, the realized losses were offset by reductions in unrealized losses. Therefore, the net effect of the transactions on the Fund's consolidated statement of operations and net asset value for the nine month period was zero.

## **UNREALIZED APPRECIATION AND DEPRECIATION OF PORTFOLIO SECURITIES**

*For the Nine Month Periods Ended July 31, 2006 and 2005.* The net change in unrealized appreciation for the nine month period ended July 31, 2006 was \$26.4 million and the net change in unrealized appreciation for the nine month period ended July 31, 2005 was \$21.4 million, an increase of \$5 million.

### ***For the Nine Month Period Ended July 31, 2006***

The Fund had a net change in unrealized appreciation on portfolio investments of \$26.4 million for the nine month period ended July 31, 2006. The change in unrealized appreciation on investment transactions for the nine month period ended July 31, 2006 primarily resulted from the Valuation Committee's decision to increase the fair value of the Fund's investments in Baltic common stock by \$7.8 million, Dakota common stock by approximately \$1.1 million, Octagon's membership interest by approximately \$562,000, Ohio common stock by \$9.2 million, ProcessClaims preferred stock by \$4.8 million and Vitality common stock and warrants by \$3.5 million and \$400,000, respectively. Other key components of the net change in unrealized appreciation was the \$2.5 million depreciation reclassification from unrealized to realized caused by the removal of Yaga and Lumeta and the \$4.8 million appreciation reclassification from the sale of ProcessClaims from the Fund's books.

### ***For the Nine Month Period Ended July 31, 2005***

Net decrease in unrealized depreciation for the nine month period ended July 31, 2005 was \$21.4 million. Such net decrease in unrealized depreciation on investment transactions for the nine months ended July 31, 2005 primarily resulted from the Valuation Committee's determinations to increase the fair value of the Fund's investments in Baltic's common stock by \$1.5 million, Dakota's common stock by \$514,000, Octagon's membership interest and warrant by \$1,022,638, Sygate's Series D preferred stock by \$4.2 million, Vendio's Series A preferred stock by \$1,565,999 and Vestal's common stock by \$950,000. The increase in the fair value of these portfolio investments resulted in a decrease in unrealized depreciation of approximately \$9.8 million. Other key components were the realization of a \$4.8 million gain on the sales of the Fund's shares of Mentor Graphics, the \$13.0 million depreciation reclassification from unrealized to realized caused by the removal of CBCA and Phosistor from the Fund's books and the \$500,000 decrease in unrealized depreciation caused by repayment in full of the Arcot loan, which was being carried below cost.

## **PORTFOLIO INVESTMENTS**

*For the Nine Month Period Ended July 31, 2006 and the Year Ended October 31, 2005.* The cost of the portfolio investments held by the Fund at July 31, 2006 and at October 31, 2005 was \$235.1 million and \$171.6 million, respectively, an increase of \$63.5 million. The aggregate fair value of portfolio investments at July 31, 2006 and at October 31, 2005 was \$212.2 million and \$122.3 million, respectively, an increase of \$89.9 million. The cost and aggregated fair value of short-term securities held by the Fund at July 31, 2006 and at October 31, 2005 was \$79.2 million and \$51.0 million, respectively, an increase of \$28.2 million. The cost and aggregate fair value of cash and cash equivalents held by the Fund at July 31, 2006 and at October 31, 2005 was \$10.5 million and \$26.3,

respectively, a decrease of approximately \$15.8 million.

***For the Nine month Period Ended July 31, 2006***

During the nine month period ended July 31, 2006, the Fund made twelve new investments, committing capital totaling approximately \$91.9 million. The investments were made in Turf, SOI, Henry, BM Auto, Storage Canada,

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Phoenix, Harmony Pharmacy, Inc., Total Safety, PreVisor, Marine, BP, and Velocitius. The amounts invested were \$11.6 million, \$5.0 million, \$5.0 million, \$15.0 million, \$6.0 million, \$8.0 million, \$200,000, \$6.0 million, \$6.0 million, \$14.0 million, \$15.0 million, and \$66,290, respectively.

The Fund also made six follow-on investments in existing portfolio companies committing capital totaling approximately \$9.5 million. During the nine month period ended July 31, 2006, the Fund invested approximately \$879,000 in Dakota by purchasing an additional 172,104 shares of common stock at an average price of \$5.11 per share. On December 22, 2005, the Fund made a follow-on investment in Baltic in the form of a \$1.8 million revolving bridge note. Baltic immediately drew down \$1.5 million from the note. On January 12, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The note matured on January 31, 2006 and has been removed from the Fund's books. On January 12, 2006, the Fund provided SGDA a \$300,000 bridge loan. On March 28, 2006, the Fund provided Baltic a \$2.0 million revolving bridge note. Baltic immediately drew down \$2.0 million from the note. On April 5, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The note matured on April 30, 2006 and has been removed from the Fund's books. On April 6, 2006, the Fund invested an additional \$2.0 million in SGDA in the form of a preferred equity security. On April 25, 2006, the Fund purchased an additional common equity security in SGDA for \$20,000. On June 30, 2006, the Fund invested \$2.5 million in Amersham in the form of a second lien loan.

At the beginning of the 2006 fiscal year, the revolving credit facility provided to SGDA had an outstanding balance of approximately \$1.2 million. During December 2005, SGDA drew down an additional \$70,600 from the credit facility. On April 28, 2006, the Fund increased the availability under the revolving credit facility by \$300,000. The balance of the bridge loan mentioned above, which would have matured on April 30, 2006, was added to the revolving credit facility and the bridge loan was eliminated from the Fund's books as a part of the refinancing. As of July 31, 2006, the entire \$1.6 million facility was drawn in full.

On December 21, 2005, Integral prepaid its senior credit facility from the Fund in full. The Fund received approximately \$850,000 from the prepayment. This amount included all outstanding principal and accrued interest. The Fund recorded no gain or loss as a result of the prepayment. Under the terms of the prepayment, the Fund returned its warrants to Integral for no consideration.

Effective December 27, 2005, the Fund exchanged \$286,200, of the \$3.25 million outstanding, of the Timberland junior revolving line of credit into 28.62 shares of common stock at a price of \$10,000 per share. As a result, as of July 31, 2006, the Fund owned 478.62 common shares of Timberland and the funded debt under the junior revolving line of credit was reduced from \$3.25 million to approximately \$2.96 million.

Effective December 31, 2005, the Fund received 373,362 shares of Series E preferred stock of ProcessClaims, Inc. in exchange for its rights under a warrant issued by ProcessClaims that has been held by the Fund since May 2002. On January 5, 2006, the Valuation Committee increased the fair value of the Fund's entire investment in ProcessClaims by \$3.3 million to \$5.7 million. Please see the paragraph below for more information on ProcessClaims.

On January 3, 2006, the Fund exercised its warrant ownership in Octagon which increased its existing membership interest. As a result, Octagon is now considered an affiliate of the Fund.

Due to the dissolution of Yaga, one of the Fund's legacy portfolio companies, the Fund realized losses on its investment in Yaga totaling \$2.3 million during the nine month period ended July 31, 2006. The Fund received no proceeds from the dissolution of Yaga and the Fund's investment in Yaga has been removed from the Fund's books. The Valuation Committee previously decreased the fair value of the Fund's investment in Yaga to zero and as a result, the Fund's realized losses were offset by reductions in unrealized losses. Therefore, the net effect of the removal of Yaga from the Fund's books on the Fund's consolidated statement of operations and NAV at July 31, 2006, was zero.

On February 24, 2006, BP repaid its second lien loan from the Fund in full. The amount of the proceeds received from the prepayment was approximately \$8.7 million. This amount included all outstanding principal, accrued interest, accrued monitoring fees and an early prepayment fee. The Fund recorded no gain or loss as a result of the repayment.

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On April 7, 2006, the Fund sold its investment in Lumeta for its carrying value of \$200,000. The Fund realized a loss on Lumeta of approximately \$200,000. However, the Valuation Committee previously decreased the fair value of the Fund's investment in Lumeta to \$200,000 and, as a result, the realized loss was offset by a reduction in unrealized losses. Therefore, the net effect of the Fund's sale of its investment in Lumeta on the Fund's consolidated statement of operations and NAV was zero.

On April 21, 2006, BM Auto repaid its bridge loan from the Fund in full. The amount of the proceeds received from the repayment was approximately \$7.2 million. This amount included all outstanding principal, accrued interest and was net of foreign taxes withheld. The Fund recorded no gain or loss as a result of the repayment.

On May 4, 2006, the Fund received a working capital adjustment of approximately \$250,000 related to the Fund's purchase of a membership interest in Turf. As a result, the Fund's cost basis in the investment was reduced.

On May 30, 2006, ProcessClaims, one of the Fund's legacy portfolio companies, entered into a definitive agreement to be acquired by CCC Information Services Inc. (CCC). The acquisition by CCC closed on June 9, 2006. As of June 9, 2006, the Fund received net proceeds of approximately \$7.9 million. The gross proceeds were approximately \$8.3 million of which approximately \$400,000 or 5% of the gross proceeds were deposited into a reserve account for one year. Due to the contingencies associated with the escrow, the Fund has not presently placed any value on the proceeds deposited in escrow and has therefore not factored such proceeds into the Fund's increased NAV. The Fund's total investment in ProcessClaims was \$2.4 million which resulted in a capital gain of approximately \$5.5 million.

On July 27, 2006, SOI repaid their loan from the Fund in full. The amount of the proceeds received from the prepayment was approximately \$4.5 million. This amount included all outstanding principal, accrued interest, and an early prepayment fee. The Fund recorded no gain or loss as a result of the prepayment.

During the nine month period ended July 31, 2006, the Valuation Committee increased the fair value of the Fund's investments in Baltic common stock by \$7.8 million, Dakota common stock by approximately \$1.1 million, Octagon's membership interest by approximately \$562,000, Ohio common stock by \$9.2 million, Process Claims preferred stock by \$4.8 million and Vitality common stock and warrants by \$3.5 million and \$400,000, respectively. In addition, increases recorded to the cost basis and fair value of the loans to Impact, JDC, Octagon, Phoenix, SP, Timberland, Turf and the Vitality preferred stock were due to the receipt of payment in kind interest/dividends totaling approximately \$911,000. Also during the nine month period ended July 31, 2006, the undistributed allocation of flow through income from the Fund's equity investment in Octagon increased the cost basis and fair value of the Fund's investment by approximately \$200,000. The increase in fair value from payment in kind interest/dividends and flow through income has been approved by the Fund's Valuation Committee.

At July 31, 2006, the fair value of all portfolio investments, exclusive of short-term securities, was \$212.2 million with a cost basis of \$235.1 million. At October 31, 2005, the fair value of all portfolio investments, exclusive of short-term securities, was \$122.3 million with a cost basis of \$171.6 million.

### ***For the Year Ended October 31, 2005***

During the year ended October 31, 2005, the Fund made six new investments, committing capital totaling approximately \$48.8 million. The investments were made in JDC, SGDA, SP, BP, Ohio and Amersham. The amounts invested were \$3.0 million, \$5.8 million, \$10.5 million, \$10 million, \$17 million and \$2.5 million, respectively.

The Fund also made three follow-on investments in existing portfolio companies committing capital totaling approximately \$5.0 million. In December 2004 and January 2005, the Fund invested a total of \$1.25 million in Timberland in the form of subordinated bridge notes. On April 15, 2005, the Fund re-issued 146,750 shares of its

treasury stock at the Fund's NAV per share of \$9.54 in exchange for 40,500 shares of common stock of Vestal. On July 8, 2005 the Fund extended Timberland a \$3.25 million junior revolving note. In accordance with the terms of the note, Timberland immediately drew \$1.3 million from the revolving note and used the proceeds to repay the subordinated bridge notes in full. The repayment included all outstanding principal and accrued interest. On July 29, 2005, the Fund invested an additional \$325,000 in Impact in the form of a secured promissory note.



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In April 2005, Octagon drew \$1.5 million from the senior secured credit facility provided to it by the Fund and repaid it in full during June 2005.

During 2005, SGDA drew approximately \$1.2 million from the revolving credit facility provided to it by the Fund. As of October 31, 2005, the entire \$1.2 million drawn from the facility remained outstanding.

On July 14, 2005 and September 28, 2005, Timberland drew an additional \$1.5 million and \$425,000, from the revolving note mentioned above, respectively. As of October 31, 2005, the note was drawn in full and the balance of \$3.25 million remained outstanding.

Also, during the year ended October 31, 2005, the Fund sold its entire investment in Sygate and received \$14.4 million in net proceeds. In addition, approximately \$1.6 million or 10% of proceeds from the sale were deposited in an escrow account for approximately one year. Due to the contingencies associated with the escrow, the Fund has not presently placed any value on the proceeds deposited in escrow and has therefore not factored such proceeds into the Fund's increased NAV. The realized gain from the \$14.4 million in net proceeds received was \$10.4 million. The Fund also sold 685,679 shares of Mentor Graphics, receiving net proceeds of approximately \$9.0 million and realized a gain on the shares sold of approximately \$5.0 million. The Fund also received approximately \$300,000 from the escrow related to the 2004 sale of BlueStar.

The Fund realized losses on CBCA of approximately \$12.0 million, Phosistor of approximately \$1.0 million and ShopEaze of approximately \$6.0 million. The Fund received no proceeds from these companies and they have been removed from the Fund's books. The Valuation Committee previously decreased the fair value of the Fund's investment in these companies to zero and as a result, the realized losses were offset by reductions in unrealized losses. Therefore, the net effect of the transactions on the Fund's consolidated statement of operations and NAV was zero.

On December 21, 2004, Determine prepaid its senior credit facility from the Fund in full. The amount of proceeds the Fund received from the repayment was approximately \$1.64 million. This amount included all outstanding principal and accrued interest. Under the terms of the early repayment, the Fund returned its 2,229,955 Series C warrants for no consideration.

On July 5, 2005, Arcot prepaid its senior credit facility from the Fund in full. The amount of proceeds the Fund received from the repayment was approximately \$2.55 million. This amount included all outstanding principal and accrued interest. Under the terms of the early repayment, the Fund returned its warrants to Arcot for no consideration.

The Fund continued to receive principal repayments on the debt securities of Integral and BP. Integral made payments during the year ended October 31, 2005, according to its credit facility agreement totaling \$1,683,336. BP made two quarterly payments during the year ended totaling \$833,333. Also, the Fund received an early repayment of Vestal's debt securities totaling \$100,000.

During the year ended October 31, 2005, the Valuation Committee increased the fair value of the Fund's investments in Baltic by \$1.5 million, Dakota by \$514,000, Octagon by \$1,022,638, Sygate by \$7.5 million (which was later realized), Vendio by \$1,565,999, Vestal by \$1,850,000 and Vitality by \$700,000. In addition, increases in the cost basis and fair value of the Octagon loan, Impact loan, Timberland loan, Vitality Series A preferred stock, JDC loan and SP loans were due to the receipt of payment in kind interest/dividends totaling \$1,370,777. Also during the year ended October 31, 2005, the undistributed allocation of flow through income from the Fund's equity investment in Octagon increased the cost basis and fair value of the investment by \$114,845.

At October 31, 2005, the fair value of all portfolio investments, exclusive of short-term securities, was \$122.3 million with a cost of \$171.6 million. At October 31, 2004, the fair value of all portfolio investments, exclusive of short-term

securities, was \$78.5 million with a cost of \$151.6 million.

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***Portfolio Companies***

During the nine month period ended July 31, 2006, the Fund had investments in the following portfolio companies:

***Actelis Networks, Inc.***

Actelis Networks, Inc. ( Actelis ), Fremont, California, provides authentication and access control solutions designed to secure the integrity of e-business in Internet-scale and wireless environments.

At October 31, 2005 and July 31, 2006 the Fund's investment in Actelis consisted of 150,602 shares of Series C preferred stock at a cost of \$5.0 million. The investment has been assigned a fair value of \$0.

***Amersham Corp.***

Amersham Corp. ( Amersham ), Louisville, Colorado, is a manufacturer of precision machined components for the automotive, furniture, security and medical device markets.

During fiscal year 2005 the Fund made an investment in Amersham. The Fund's investment in Amersham consists of \$2.5 million in purchased notes, bearing annual interest at 10%. The notes have a maturity date of June 29, 2010. The notes have a principal face amount and cost basis of \$2.5 million.

On June 30, 2006, the Fund made an additional investment in Amersham consisting of an additional \$2.5 million note bearing annual interest at 16% from June 30, 2006 to June 30, 2008. The interest rate then steps down to 14% for the period July 1, 2008 to June 30, 2010, steps down to 13% for the period July 1, 2010 to June 30, 2012 and steps down again to 12% for the period July 1, 2012 to June 30, 2013. The note has a maturity date of June 30, 2013. The note has a principal face amount and cost basis of \$2.5 million.

At July 31, 2006, the notes had a combined outstanding balance, cost and fair value of \$5.0 million.

***Baltic Motors Corporation***

Baltic Motors Corporation ( Baltic ), Purchase, New York, is a U.S. company focused on the importation and sale of Ford and Land Rover vehicles and parts throughout Latvia, a member of the European Union.

At October 31, 2005 and July 31, 2006, the Fund's investment in Baltic consisted of 54,947 shares of common stock at a cost of \$6.0 million and a mezzanine loan with a cost basis of \$4.5 million. The loan has a maturity date of June 24, 2007 and earns interest at 10% per annum.

At October 31, 2005, the investment in Baltic was assigned a fair value of \$12.0 million.

On December 22, 2005, the Fund extended to Baltic a \$1.8 million revolving bridge note. Baltic immediately drew down \$1.5 million from the note. On January 12, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The note ended on January 31, 2006 and has been removed from the Fund's books.

On March 28, 2006, the Fund extended to Baltic a \$2.0 million revolving bridge note. Baltic immediately drew down \$2.0 million from the note. On April 5, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The note ended on April 30, 2006 and has been removed from the Fund's books.

During the nine month period ended July 31, 2006, the Valuation Committee increased the fair value of the Fund's equity investment in Baltic by \$7.8 million from \$7.5 million to \$15.32 million.

At July 31, 2006, the Fund's investment in Baltic was assigned a fair value of \$19.8 million. Michael Tokarz, Chairman of the Fund, and Christopher Sullivan, an employee of the Fund, serve as directors for Baltic.

***BP Clothing, LLC***

BP Clothing, LLC ( BP ), Pico Rivera, California, is a company which designs, manufactures, markets and distributes, Baby Phat(R), a line of women's clothing.

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On June 3, 2005, the Fund made an initial investment in BP consisting of a \$10 million second lien loan bearing annual interest at LIBOR plus 8% for the first year and variable interest rates for the remainder of the four year term. The loan has a \$10.0 million principal face amount and was issued at a cost basis of \$10.0 million. The loan's cost basis was subsequently discounted to reflect loan origination fees received. The Fund is scheduled to receive quarterly principal repayments totaling \$625,000 per quarter with the remaining principal balance due upon maturity.

On February 24, 2006, BP repaid its initial second lien loan from the Fund in full. The amount of the proceeds received from the prepayment was approximately \$8.7 million. This amount included all outstanding principal, accrued interest, accrued monitoring fees and an early prepayment fee.

On July 19, 2006, the Fund extended to BP a subsequent \$10 million second lien loan bearing annual interest at 14%. The loan has a \$10.0 million principal face amount and was issued at a cost basis of \$10.0 million. The loan's cost basis was subsequently discounted to reflect loan origination fees received. The maturity date of the loan is July 19, 2012. The principal balance is due upon maturity.

On July 20, 2006, the Fund purchased at a discount \$5 million in loan assignments in BP. The \$3 million term loan A bears annual interest at LIBOR plus 4.25% or Prime Rate plus 3.25%. The \$2 million term loan B bears annual interest at LIBOR plus 6.40% or Prime Rate plus 5.40%. The interest rate option on the loan assignments is at the borrower's discretion. Both loans mature on July 18, 2011.

At July 31, 2006, the loans had a combined outstanding balance and cost basis of \$14.7 million. The loan and loan assignments had a combined fair value of \$14.9 million.

### ***Dakota Growers Pasta Company, Inc.***

Dakota Growers Pasta Company, Inc. ( "Dakota" ), Carrington, North Dakota, is the third largest manufacturer of dry pasta in North America and a market leader in private label sales. Dakota and its partners in DNA Dreamfields Company, LLC introduced a new process that is designed to reduce the number of digestible carbohydrates found in traditional pasta products.

At October 31, 2005, the Fund's investment in Dakota consisted of 909,091 shares of common stock with a cost of \$5.0 million and assigned fair value of \$5.5 million.

During the nine months ended July 31, 2006, the Fund purchased an additional 172,104 shares of common stock at an average price of \$5.11 per share or approximately \$879,000.

Effective January 31, 2006 and April 30, 2006, the Valuation Committee increased the fair value of the newly purchased shares to the carrying value of the original shares or approximately \$6.07. The increase in the fair value of the newly purchased shares over their cost was approximately \$164,000.

Effective July 31, 2006, the Valuation Committee increased the fair value of the investment by approximately \$900,000.

At July 31, 2006, the Fund's investment in Dakota consisted of 1,081,195 shares of common stock with a cost of \$5.9 million and assigned fair value of \$7.5 million.

Michael Tokarz, Chairman of the Fund, serves as a director of Dakota.

### ***DPHI, Inc. (formerly DataPlay, Inc.)***

DPHI, Inc. ( DPHI ), Boulder, Colorado, is trying to develop new ways of enabling consumers to record and play digital content.

At October 31, 2005 and July 31, 2006, the Fund's investment in DPHI consisted of 602,131 shares of Series A-1 preferred stock with a cost of \$4.5 million. This investment has been assigned a fair value of \$0.

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***Endymion Systems, Inc.***

Endymion Systems, Inc. ( Endymion ), Oakland, California, is a single source supplier for strategic, web-enabled, end-to-end business solutions designed to help its customers leverage Internet technologies to drive growth and increase productivity.

At October 31, 2005 and July 31, 2006, the Fund's investment in Endymion consisted of 7,156,760 shares of Series A preferred stock with a cost of \$7.0 million. The investment has been assigned a fair value of \$0.

***Foliofn, Inc.***

Foliofn, Inc. ( Foliofn ), Vienna, Virginia, is a financial services technology company that offers investment solutions to financial services firms and investors.

At October 31, 2005 and July 31, 2006, the Fund's investment in Foliofn consisted of 5,802,259 shares of Series C preferred stock with a cost of \$15.0 million. The investment had been assigned a fair value of \$0. Bruce Shewmaker, an officer of the Fund, serves as a director of Foliofn.

***Harmony Pharmacy & Health Center, Inc.***

Harmony Pharmacy & Health Center, Inc. ( Harmony Pharmacy ), Purchase, NY, is an operator of pharmacy and healthcare centers primarily in airports in the United States.

The Fund invested \$200,000 in Harmony Pharmacy in the form of a demand note. The note bears annual interest at 10% and is callable anytime at the Fund's discretion.

At July 31, 2006, the note had an outstanding balance, cost basis and fair value of \$200,000.

***Henry Company***

Henry Company ( Henry ), Huntington Park, California, is a manufacturer and distributor of building products and specialty chemicals.

The Fund purchased the \$5 million in loan assignments in Henry Company. The \$3 million term loan A bears annual interest at LIBOR plus 3.5% and matures on April 6, 2011. The \$2 million term loan B bears annual interest at LIBOR plus 7.75% and also matures on April 6, 2011.

At July 31, 2006, the loans had a combined outstanding balance, cost basis, and fair value of \$5.0 million.

***Impact Confections, Inc.***

Impact Confections, Inc. ( Impact ), Roswell, New Mexico founded in 1981, is a manufacturer and distributor of children's candies.

The Fund's investment in Impact consists of 252 shares of common stock at a cost of \$10,714.28 per share or \$2.7 million and a loan to Impact in the form of a senior subordinated note with an outstanding balance of \$5.0 million. The Fund's common stock has a preferred status if there is a liquidation of the company. The loan bears annual interest at 17.0% and matures on July 30, 2009. The loan was issued at a cost basis of \$5.0 million. The loan's cost basis was then discounted to reflect loan origination fees received.

On July 29, 2005, the Fund made a \$325,000 follow-on investment in Impact in the form of a secured promissory note which bears annual interest at LIBOR plus 4%. The promissory note has a three year term. The note has a \$325,000 principal face amount and was issued at a cost basis of \$325,000. The note's cost basis was then discounted to reflect loan origination fees received.

At October 31, 2005, the Fund's investment in Impact consisted of 252 shares of common stock at a cost of \$2.7 million, the loan to Impact with an outstanding balance of \$5.23 million and the secured promissory note with an outstanding balance of \$325,000. The cost basis of the loan and promissory note at October 31, 2005 was approximately \$5.13 million and \$319,000, respectively. At October 31, 2005, the equity investment, loan and secured promissory note were assigned fair values of \$2.7 million, \$5.23 million and \$325,000 respectively.



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At July 31, 2006, the Fund's investment in Impact consisted of 252 shares of common stock at a cost of \$2.7 million, the loan to Impact with an outstanding balance of \$5.4 million and the secured promissory note with a balance of \$325,000. The cost basis of the loan and promissory note at July 31, 2006 were approximately \$5.33 million and \$321,000 respectively. At July 31, 2006, the equity investment, loan and secured promissory note were assigned fair values of \$2.7 million, \$5.4 million and \$325,000, respectively. The increase in the outstanding balance, cost and fair value of the loan is due to the amortization of loan origination fees and the capitalization of payment in kind interest. These increases were approved by the Fund's Valuation Committee.

Puneet Sanan and Shivani Khurana, employees of the Fund, serve as directors of Impact.

***Integral Development Corporation***

Integral Development Corporation ( Integral ), Mountain View, California, is a developer of technology for financial institutions to expand, integrate and automate their capital markets businesses and operations.

At October 31, 2005, the Fund's investment in Integral consisted of an outstanding balance on the loan of \$1.12 million with a cost of \$1.12 million. The investment had been assigned a fair value of \$1.12 million.

During the nine month period ended July 31, 2006, Integral prepaid its outstanding loan balance in full including all accrued interest. The Fund recorded no gain or loss as a result of the prepayment. Under the terms of the prepayment, the Fund returned its warrants to Integral for no consideration.

As of July 31, 2006, the Fund no longer held any investment in Integral.

***JDC Lighting, LLC***

JDC Lighting, LLC ( JDC ), New York, New York, is a distributor of commercial lighting and electrical products.

The Fund's investment in JDC consists of a \$3.0 million senior subordinated loan, bearing annual interest at 17% over a four year term. The loan has a \$3.0 million principal face amount and was issued at a cost basis of \$3.0 million. The loan's cost basis was discounted to reflect loan origination fees received.

At October 31, 2005, the loan had an outstanding balance of \$3.09 million with a cost of \$3.03 million. The loan was assigned a fair value of \$3.09 million.

At July 31, 2006, the loan had an outstanding balance of \$3.16 million with a cost of \$3.11 million. The loan was assigned a fair value of \$3.16 million. The increase in the outstanding balance, cost and fair value of the loan, is due to the amortization of loan origination fees and the capitalization of payment in kind interest. These increases were approved by the Fund's Valuation Committee.

***Lumeta Corporation***

Lumeta Corporation ( Lumeta ), Somerset, New Jersey, is a developer of network management, security, and auditing solutions. The company provides businesses with an analysis of their network security that is designed to reveal the vulnerabilities and inefficiencies of their corporate intranets.

At October 31, 2005 and January 31, 2006, the Fund's investment in Lumeta consisted of 384,615 shares of Series A preferred stock and 266,846 shares of Series B preferred stock with a combined cost of approximately \$406,000.

At October 31, 2005 the investments were assigned a fair value of \$200,000, or approximately \$0.11 per share of Series A preferred stock and approximately \$0.59 per share of Series B preferred stock.

On April 7, 2006, the Fund sold its investment in Lumeta for its carrying value of \$200,000. The Fund realized a loss on Lumeta of approximately \$200,000. However, the Valuation Committee previously decreased the fair value of the Fund's investment in this company to \$200,000 and as a result, the realized loss was offset by a reduction in unrealized losses. Therefore, the net effect of the Fund's sale of its investment in Lumeta on the Fund's consolidated statement of operations and NAV was zero.

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As of July 31, 2006, the Fund no longer held any investment in Lumeta.

***Mainstream Data, Inc.***

Mainstream Data, Inc. ( Mainstream ), Salt Lake City, Utah, builds and operates satellite, internet, and wireless broadcast networks for information companies. Mainstream networks deliver text news, streaming stock quotations, and digital images to subscribers around the world.

At October 31, 2005 and July 31, 2006, the Fund's investment in Mainstream consisted of 5,786 shares of common stock with a cost of \$3.75 million. The investment has been assigned a fair value of \$0.

***Marine Exhibition Corporation***

Marine Exhibition Corporation ( Marine ), Miami, Florida, owns and operates the Miami Seaquarium. The Seaquarium is a family-oriented entertainment park.

On July 11, 2006, the Fund extended to Marine a \$10 million senior secured loan bearing annual interest at 11%. The senior secured loan has a \$10.0 million principal face amount and was issued at a cost basis of \$10.0 million. The loan's cost basis was subsequently discounted to reflect loan origination fees received. The maturity date of the loan is June 30, 2013. The Fund also extended a secured revolving note bearing interest at LIBOR plus 1%. The amount available to draw down at any time on the note is \$2.0 million. The Fund also invested \$2.0 million into Marine in the form of preferred stock, purchasing 2,000 shares. The dividend rate on the preferred stock is 12% per annum.

At July 31, 2006, the Fund's senior secured loan had an outstanding balance of \$10.0 million with a cost of \$9.8 million. The senior secured loan was assigned a fair value of \$10.0 million. The secured revolving note was not drawn upon. The preferred stock had been assigned a fair value of \$2.0 million.

***Octagon Credit Investors, LLC***

Octagon Credit Investors, LLC ( Octagon ), is a New York-based asset management company that manages leveraged loans and high yield bonds through collateralized debt obligations ( CDO ) funds.

The Fund's investment in Octagon consists of a \$5,000,000 senior subordinated loan, bearing annual interest at 15% over a seven year term. The loan has a \$5,000,000 principal face amount and was issued at a discounted cost basis of \$4,450,000. The loan included detachable warrants with a cost basis of \$550,000. The Fund also provided a \$5,000,000 senior secured credit facility to Octagon. This credit facility expires on May 7, 2009 and bears annual interest at LIBOR plus 4%. The Fund receives a 0.50% unused facility fee on an annual basis and a 0.25% servicing fee on an annual basis for maintaining the credit facility. The Fund also made a \$560,000 equity investment in Octagon which provides the Fund a membership interest in Octagon.

At October 31, 2005, the loan had an outstanding balance of \$5.15 million with a cost of \$4.56 million. The loan was carried at a fair value of \$4.66 million.

At October 31, 2005, the equity investment and detachable warrants had a cost basis of \$724,857 and \$550,000 respectively. The equity investment and detachable warrants were assigned a fair value of \$1,228,083 and \$1,069,457, respectively.

On January 3, 2006, the Fund exercised its warrant ownership in Octagon for no additional cost which increased its existing membership interest in Octagon. As a result, Octagon is now considered an affiliate under the definition of

the 1940 Act.

Effective January 31, 2006, the Valuation Committee determined to increase the fair value of the Fund's equity investment in Octagon by \$562,291.

The cost basis and fair value of the equity investment was also increased by approximately \$200,000 to account for the Fund's allocated portion of the flow-through income, from its membership interest in Octagon, which was not distributed to members. This flow-through income is recorded by the Fund as other income.

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At July 31, 2006, the loan had an outstanding balance of \$5.21 million with a cost of \$4.68 million. The loan was assigned a fair value of \$4.77 million. The increase in the outstanding balance, cost and fair value of the loan is due to the accretion of the market discount, the amortization of loan origination fees and the capitalization of payment in kind interest. These increases were approved by the Fund's Valuation Committee.

At July 31, 2006, the equity investment had a cost basis of \$1.47 million and was assigned a fair value of \$3.06 million.

***Ohio Medical Corporation***

Ohio Medical Corporation ( Ohio ), Gurnee, Illinois, is a manufacturer and supplier of suction and oxygen therapy products, as well as medical gas equipment.

During fiscal year 2005, the Fund invested \$17 million and sponsored the acquisition of General Electric's Ohmeda Brand Suction and Oxygen Therapy business unit ( GE-SOT ), a leading global supplier of suction and oxygen therapy products. On July 14, 2005, in conjunction with this transaction, the Fund acquired GE-SOT's largest supplier, Squire Cogswell/Aeros Instruments, Inc. and merged both businesses creating Ohio Medical Corporation.

The Fund's investment in Ohio consists of 5,620 shares of common stock with a cost basis of \$17 million.

As of October 31, 2005, the Fund's investment was assigned a fair value of \$17 million.

During the nine month period ended July 31, 2006, the Valuation Committee increased the fair value of the Fund's equity investment in Ohio by \$9.2 million from \$17.0 million to approximately \$26.2 million.

As of July 31, 2006, the cost basis and fair value of the Fund's investment in Ohio was \$17.0 million and \$26.2 million, respectively.

Michael Tokarz, Chairman of the Fund, Peter Seidenberg, Chief Financial Officer of the Fund and David Hadani, an employee of the Fund, serve as directors of Ohio.

***Phoenix Coal Corporation***

Phoenix Coal Corporation ( Phoenix ), Madisonville, KY, is engaged in the acquisition, development, production and sale of bituminous coal reserves and resources located primarily in the Illinois Basin. With offices in Madisonville, Kentucky and Champaign, Illinois, the company is focused on consolidating small and medium-sized coal mining projects and applying proprietary technology to increase efficiency and enhance profit margins.

On April 4, 2006, the Fund purchased 1 million shares of common stock of Phoenix for a purchase price of \$500,000. On June 8, 2006, the Fund purchased an additional 666,667 shares of common stock of Phoenix for a purchase price of approximately \$500,000.

Also, on June 8, 2006, the Fund committed to Phoenix \$7.0 million in debt. The first \$3.5 million second lien loan bears annual interest at 15%. The loan was discounted for the loan origination fees received.

On July 26, 2006 the Fund extended to Phoenix the remaining portion of the \$7.0 million commitment. This \$3.5 million second lien loan also bears annual interest at 15%. The maturity date for both loans is June 8, 2011.

As of July 31, 2006, the cost basis and fair value of the Fund's investment in Phoenix was \$7.9 million and \$8.0, respectively. The increase in cost and fair value of the loan is due to the amortization of loan origination fees and the capitalization of payment in kind interest. These increases were approved by the Fund's Valuation Committee.

***PreVisor, Inc.***

PreVisor, Inc. ( PreVisor ), Roswell, Georgia, provides pre-employment testing and assessment solutions and related professional consulting services.

On May 31, 2006, the Fund invested \$6 million in PreVisor in the form of common stock. Mr. Tokarz, our Chairman and Portfolio Manager, is a minority non-controlling shareholder of PreVisor. Our board of directors,

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including all of our directors who are not interested persons of the Fund, as defined by the 1940 Act (the Independent Directors ), approved the transaction (Mr. Tokarz recused himself from making a determination or recommendation on this matter).

As of July 31, 2006, the common stock had been assigned a fair value of \$6.0 million.

### ***ProcessClaims, Inc.***

ProcessClaims, Inc. ( ProcessClaims ), Manhattan Beach, California, provides web-based solutions and value added services that streamline the automobile insurance claims process for the insurance industry and its partners.

At October 31, 2005, the Fund's investments in ProcessClaims consisted of 6,250,000 shares of Series C preferred stock, 849,257 shares of Series D preferred stock, and 873,362 warrants to purchase 873,362 shares of Series E convertible preferred stock with a combined cost of \$2.4 million. The investment in the Series C preferred stock was assigned a fair value of \$2.0 million, the investment in the Series D preferred stock was assigned a fair value of \$400,000, and the investment in the Series E warrants was assigned a fair value of \$0.

Effective December 31, 2005, in a cashless transaction, the Fund received 373,362 shares of Series E preferred stock of ProcessClaims in exchange for its rights under a warrant issued by ProcessClaims that has been held by the Fund since May 2002.

On January 5, 2006, the Fund's Valuation Committee determined to increase the fair value of the Fund's entire investment in ProcessClaims by \$3.3 million.

During March 2006, the Fund was granted and accepted 50,000 options to purchase shares of ProcessClaims common stock. Bruce Shewmaker, an officer of the Fund, serves as a director of ProcessClaims. The options were granted for Bruce Shewmaker's service on ProcessClaims board of directors. The options vested immediately, have an exercise price of \$0.32 per share and have an expiration date of ten years from the date of grant.

Effective April 30, 2006, the Fund's Valuation Committee determined to increase the fair value of the Fund's investment in ProcessClaims by approximately \$760,000.

At April 30, 2006, the Fund's investments in ProcessClaims consisted of 6,250,000 shares of Series C preferred stock, 849,257 shares of Series D preferred stock, 373,362 shares of Series E convertible preferred stock and 50,000 common stock options with a combined cost of \$2.4 million. The investment in the Series C preferred stock was assigned a fair value of \$5.2 million, the investment in the Series D preferred stock was assigned a fair value of \$831,000, the investment in the Series E warrants was assigned a fair value of \$446,000 and the options were fair valued at \$9,000.

On May 30, 2006, ProcessClaims, one of the Fund's legacy portfolio companies, entered into a definitive agreement to be acquired by CCC Information Services Inc. ( CCC ). The acquisition by CCC closed on June 9, 2006. As of June 9, 2006, the Fund received net proceeds of approximately \$7.9 million. The gross proceeds were approximately \$8.3 million of which approximately \$400,000 or 5% of the gross proceeds were deposited into a reserve account for one year. Due to the contingencies associated with the escrow, the Fund has not presently placed any value on the proceeds deposited in escrow and has therefore not factored such proceeds into the Fund's increased NAV. The Fund's total investment in ProcessClaims was \$2.4 million which resulted in a capital gain of approximately \$5.5 million.

As of July 31, 2006, the Fund no longer held any investment in ProcessClaims.

***SafeStone Technologies PLC***

SafeStone Technologies PLC ( SafeStone ), Old Amersham, UK, provides organizations with technology designed to secure access controls across the extended enterprise, enforcing compliance with security policies and enabling effective management of the corporate IT and e-business infrastructure.

At October 31, 2005 and July 31, 2006, the Fund's investments in SafeStone consisted of 2,106,378 shares of Series A ordinary stock with a cost of \$4.0 million. The investment has been assigned a fair value of \$0 by the Fund's Valuation Committee.



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***SGDA Sanierungsgesellschaft fur Deponien und Altasten mbH***

SGDA Sanierungsgesellschaft fur Deponien und Altasten mbH ( SGDA ), Zella-Mehlis, Germany, is a company that is in the business of landfill remediation and revitalization of contaminated soil.

The Fund's investment in SGDA consists of a \$4.6 million term loan, bearing annual interest at 7% over a four and a half year term. The term loan has a \$4.6 million principal face amount and was issued at a discounted cost basis of \$4.3 million. The loan included a common equity ownership interest in SGDA with a cost basis of \$315,000. The Fund also made available to SGDA a \$1.3 million revolving credit facility that bears annual interest at 7%. The credit facility expires on August 25, 2006.

At October 31, 2005, the term loan had an outstanding balance of \$4.58 million with a cost of \$4.3 million. The term loan was carried at a fair value of \$4.3 million. The increase in the cost and fair value of the loan is due to the accretion of the market discount of the term loan. The ownership interest in SGDA has been assigned a fair value of \$315,000 which is its cost basis. As of October 31, 2005, SGDA had drawn \$1,237,700 upon the revolving credit facility.

During December 2005, SGDA drew an additional \$70,600 on the revolving line of credit. This brought the amount drawn under the line of credit to \$1.3 million, the maximum available under the line of credit.

Also during December 2005, the Fund did not accrue, and therefore was not paid, approximately \$23,000 in implied interest owed from the SGDA loan and revolving credit facility. This was due to a contractual agreement (based on German tax provisions) to cap the interest paid by SGDA to Fund, in the aggregate, at 240,000 Euro in any given calendar year. Despite forgoing this interest management believes there is no credit risk associated with this portfolio company.

On January 12, 2006, the Fund extended to SGDA a \$300,000 bridge loan. The loan bore annual interest at 7% and had a maturity date of April 30, 2006.

On April 6, 2006, the Fund invested an additional \$2.0 million into SGDA in the form of a preferred equity interest. On April 25, 2006 the Fund purchased an additional common equity interest in SGDA for \$23,551.

On April 28, 2006, the Fund increased the availability under the revolving credit facility by \$300,000. The balance of the bridge loan mentioned above, which would have matured on April 30, 2006, was added to the revolving credit facility and the bridge loan was removed from the Fund's books as a part of the refinancing. As of July 31, 2006, the entire \$1.6 million facility was drawn in full.

At July 31, 2006, the term loan had an outstanding balance of \$4.6 million with a cost of \$4.4 million. The term loan was carried at a fair value of \$4.4 million. The increase in the cost and fair value of the loan is due to the accretion of the market discount of the term loan. The ownership interest in SGDA has been assigned a fair value of \$338,551 which is its cost basis. The line of credit has been assigned a fair value of \$1.6 million. The preferred stock has been assigned a fair value of \$2.0 million.

***Sonexis, Inc.***

Sonexis, Inc. ( Sonexis ), Tewksbury, Massachusetts, is the developer of a new kind of conferencing solution Sonexis ConferenceManager a modular platform that is designed to support a breadth of audio and web conferencing functionality to deliver rich media conferencing.

At October 31, 2005 and July 31, 2006, the Fund's investment in Sonexis consisted of 131,615 shares of common stock with a cost of \$10.0 million. The investment has been assigned a fair value of \$0.

***SIA BM Auto***

SIA BM Auto ( BM Auto ), Riga, Latvia, is a company focused on the importation and sale of BMW vehicles and parts throughout Latvia, a member of the European Union.

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The Fund's investment in BM Auto consisted of 47,300 shares of common stock at a cost of \$8 million and a sixty day bridge loan with a cost basis of \$7.0 million. The loan was repaid in full, including all principal and accrued interest, on April 21, 2006.

At July 31, 2006, the Fund's investment in BM Auto was assigned a fair value of \$8 million.

***SP Industries, Inc.***

SP Industries, Inc. ( SP ), Warminster, Pennsylvania, is a designer, manufacturer, and marketer of laboratory research and process equipment, glassware and precision glass components, and configured-to-order manufacturing equipment.

The Fund's investment in SP consists of a \$6.5 million mezzanine loan and a \$4.0 million term loan. The mezzanine loan bears annual interest at 17% over a seven year term. The mezzanine loan has a \$6.5 million principal face amount and was issued at a cost basis of \$6.5 million. The mezzanine loan's cost basis was discounted to reflect loan origination fees received. The term loan bears annual interest at LIBOR plus 10% over a five year term. The term loan has a \$4.0 million principal face amount and was issued at a cost basis of \$4.0 million. The term loan's cost basis was discounted to reflect loan origination fees received by the Fund.

At October 31, 2005, the mezzanine loan and the term loan had outstanding balances of \$6.65 million and \$4.02 million respectively with cost basis of \$6.4 million and \$3.95 million, respectively. The mezzanine loan and term loan were assigned fair values of \$6.65 million and \$4.02 million, respectively.

At July 31, 2006, the mezzanine loan and the term loan had outstanding balances of \$6.88 million and \$4.05 million, respectively, with a cost basis of \$6.65 million and \$3.99 million, respectively. The mezzanine loan and term loan were assigned fair values of \$6.88 million and \$4.05 million, respectively. The increase in the outstanding balance, cost and fair value of the loan, is due to the amortization of loan origination fees and the capitalization of payment in kind interest. These increases were approved by the Fund's Valuation Committee.

***Strategic Outsourcing, Inc.***

Strategic Outsourcing, Inc. ( SOI ), Charlotte, North Carolina, is a professional employer organization that provides services that enable small businesses to outsource their human resource function.

The Fund purchased a \$5 million loan assignment in SOI. The loan has a 5 year term and bears annual interest at LIBOR plus 5.25%

On December 31, 2005, SOI repaid a portion of its outstanding loan. The Fund's prorated share of the repayment was approximately \$108,000.

On March 31, 2006, SOI repaid a portion of its outstanding loan. The Fund's prorated share of the repayment was approximately \$108,000.

On May 3, 2006, SOI repaid a portion of its outstanding loan. The Fund's prorated share of the repayment was approximately \$440,000.

On July 27, 2006, SOI repaid the loan assignment in full. The amount of the proceeds received from the prepayment was approximately \$4.5 million. This amount included all outstanding principal, accrued interest, and an early prepayment fee.

As of July 31, 2006, the Fund no longer held any investment in SOI.

***Storage Canada, LLC***

Storage Canada, LLC ( Storage Canada ), Omaha, NE, is a real estate company that owns and develops self-storage facilities throughout the U.S. and Canada.

On March 30, 2006, the Fund provided a \$6 million loan commitment to Storage Canada on which Storage Canada immediately borrowed \$1.3 million. The commitment expires after one year, but may be renewed with the consent of both parties. The initial borrowing on the loan bears annual interest at 8.75% and has a maturity date of

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March 30, 2013. Any additional borrowings will mature seven years from the date of the subsequent borrowing. The Fund receives monthly principal payments. The Fund also receives a fee of 0.25% on the unused portion of the loan.

At July 31, 2006, the Fund's investment in Storage Canada had an outstanding balance and cost basis of \$1.3 million and was assigned a fair value of \$1.3 million.

### ***Timberland Machines & Irrigation, Inc.***

Timberland Machines & Irrigation, Inc. ( Timberland ), Enfield, Connecticut, is a distributor of landscaping outdoor power equipment and irrigation products.

The Fund's investment in Timberland consists of a \$6 million senior subordinated loan, bearing annual interest at 17% over a five year term. The note has a \$6 million principal face amount and was issued at a cost basis of \$6 million. The loan's cost basis was then discounted to reflect loan origination fees received. The Fund also owns 450 shares of common stock for a \$4.5 million equity investment in Timberland. The Fund has an option to purchase an additional 150 shares of common stock at a price of \$10,000 per share. The Fund has also extended to Timberland a \$3.25 million junior revolving note. The junior revolving note bears interest at 12.5% per annum and matures on July 7, 2007.

Timberland has a floor plan financing program administered by Transamerica Commercial Finance Corporation. As is typical in Timberland's industry, under the terms of the dealer financing arrangement, Timberland guarantees the repurchase of product from Transamerica, if a dealer defaults on payment and the underlying assets are repossessed. The Fund has agreed to be a co-guarantor of this repurchase commitment, but its maximum potential exposure as a result of the guarantee is contractually limited to \$0.5 million.

At October 31, 2005, the Fund's mezzanine loan had an outstanding balance of \$6.32 million with a cost of \$6.23 million. The mezzanine loan was assigned a fair value of \$6.32 million. The junior revolving note was fully drawn upon and assigned a fair value of \$3.25 million. The common stock had been assigned a fair value of \$4,500,000. The warrant was assigned a fair value of \$0.

Effective December 27, 2005, the Fund converted \$286,200 of the Timberland junior revolving line of credit into 28.62 shares of common stock at a price of \$10,000 per share. As a result, as of July 31, 2006 the Fund owned 478.62 common shares and the funded debt under the junior revolving line of credit was reduced from \$3.25 million to approximately \$2.96 million.

During the quarter ended, April 30, 2006, Timberland had repaid an additional \$500,000 on the note leaving the total amount outstanding at approximately \$2.46 million.

On July 1, 2006, the Fund reduced the interest rate on the mezzanine loan from 17% to 14.426%.

During the quarter ended, July 31, 2006, Timberland repaid an additional \$500,000 and drew down \$1.0 million on the note leaving the total amount outstanding at approximately \$2.96 million.

At July 31, 2006, the Fund's mezzanine loan had an outstanding balance of \$6.53 million with a cost of \$6.47 million. The mezzanine loan was assigned a fair value of \$6.53 million. The increase in the outstanding balance, cost and fair value of the loan is due to the amortization of loan origination fees and the capitalization of payment in kind interest. These increases were approved by the Fund's Valuation Committee. The junior revolving note was assigned a fair value of \$2.96 million. The common stock had been assigned a fair value of \$4.79 million. The warrant was assigned a fair value of \$0.

Michael Tokarz, Chairman of the Fund, and Puneet Sanan, an employee of the Fund, serve as directors of Timberland.

***Total Safety U.S., Inc.***

Total Safety U.S., Inc. ( Total Safety ), Houston, Texas, is the leading provider of safety equipment and related services to the refining, petrochemical, and oil exploration and production industries.

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The Fund purchased \$6 million of loan assignments in Total Safety. The \$5 million term loan A bears annual interest at LIBOR plus 4.5% and matures on December 31, 2010. The \$1 million term loan B bears annual interest at LIBOR plus 8.5% and also matures on December 31, 2010. On June 30, 2006, the Fund received a quarterly principal payment for each loan totaling approximately \$55,046.

At July 31, 2006, the loans had a combined outstanding balance and cost basis of \$5.9 million. The loan assignments had a fair value of \$5.9 million.

### ***Turf Products, LLC***

Turf Products, LLC (Turf), Enfield, Connecticut, is a wholesale distributor of golf course and commercial turf maintenance equipment, golf course irrigation systems and consumer outdoor power equipment.

The Fund's investment in Turf consists of senior subordinated loan, bearing interest at 15% per annum over a five year term. The note has a \$7.5 million principal face amount and was issued at a cost basis of \$7.5 million. The loan's cost basis was then discounted to reflect loan origination fees received. The Fund also owns a membership interest from a \$3.8 million equity investment in Turf. The Fund also has an option to purchase an additional 15% of the company.

At July 31, 2006, the Fund's mezzanine loan had an outstanding balance of \$7.68 million with a cost of \$7.63 million. The loan was assigned a fair value of \$7.68 million. The increase in the outstanding balance, cost and fair value of the loan is due to the amortization of loan origination fees and the capitalization of payment in kind interest. These increases were approved by the Fund's Valuation Committee. The membership interest has been assigned a fair value of \$3.8 million. The option was assigned a fair value of \$0.

Michael Tokarz, Chairman of the Fund, and Puneet Sanan and Shivani Khurana, employees of the Fund, serve as directors of Turf.

### ***Velocitius B.V.***

Velocitius B.V. (Velocitius), a Netherlands based company, manages Germany based wind farms through operating subsidiaries.

On May 10, 2006, the Fund made an equity investment of approximately \$66,290 in Velocitius.

At July 31, 2006, the equity investment had been assigned a fair value of \$66,290.

### ***Vendio Services, Inc.***

Vendio Services, Inc. (Vendio), San Bruno, California, offers small businesses and entrepreneurs resources to build Internet sales channels by providing software solutions designed to help these merchants efficiently market, sell and distribute their products.

At October 31, 2005 and July 31, 2006, the Fund's investments in Vendio consisted of 10,476 shares of common stock and 6,443,188 shares of Series A preferred stock at a total cost of \$6.6 million. The investments were assigned a fair value of \$2.7 million, \$0 for the common stock and \$2.7 million for the Series A preferred stock. Bruce Shewmaker, an officer of the Fund, serves as a director of Vendio.

### ***Vestal Manufacturing Enterprises, Inc.***

Vestal Manufacturing Enterprises, Inc. ( Vestal ), Sweetwater, Tennessee, is a market leader for steel fabricated products to brick and masonry segments of the construction industry. Vestal manufactures and sells both cast iron and fabricated steel specialty products used in the construction of single-family homes.

The Fund's investment in Vestal consists of 81,000 shares of common stock at a cost of \$1.85 million and a loan of \$900,000 to Vestal in the form of a senior subordinated promissory note. The loan has a maturity date of April 29, 2011 and earns interest at 12% per annum.



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At October 31, 2005 and July 31, 2006, the senior subordinated promissory note had an outstanding balance, cost, and fair value of \$900,000. The 81,000 shares of common stock of Vestal that had a cost basis of \$1.85 million were assigned a fair value of \$3.7 million. David Hadani and Ben Harris, employees of the Fund, serve as directors of Vestal.

### ***Vitality Foodservice, Inc.***

Vitality Foodservice, Inc. ( Vitality ), Tampa, Florida, is a market leader in the processing and marketing of dispensed and non-dispensed juices and frozen concentrate liquid coffee to the foodservice industry. With an installed base of over 42,000 dispensers worldwide, Vitality sells its frozen concentrate through a network of over 350 distributors to such market niches as institutional foodservice, including schools, hospitals, cruise ships, hotels and restaurants.

The Fund's investment in Vitality consists of 500,000 shares of common stock at a cost of \$5 million and 1,000,000 shares of Series A convertible preferred stock at a cost of \$10 million. The convertible preferred stock has a liquidation date of September 24, 2011 and has a yield of 13% per annum. The convertible preferred stock also has detachable warrants granting the Fund the right to purchase 211,243 shares of common stock at the price of \$0.01 per share.

At October 31, 2005, the investment in Vitality consisted of 500,000 shares of common stock at a cost of \$5 million and 1,000,000 shares of Series A convertible preferred stock at a cost of \$10.52 million. The common stock, Series A convertible preferred stock and warrants were assigned fair values of \$5 million, \$10.52 million and \$700,000, respectively.

Effective January 31, 2006, the Valuation Committee determined to increase the fair value of the common stock and warrants in Vitality by \$3.5 million and \$400,000, respectively.

During the nine month period ended July 31, 2006, the Fund reclassified dividend income received from Vitality totaling approximately \$900,000 to return of capital. The reclassification occurred due to the determination that Vitality estimated that it will not have taxable earnings and profits for their fiscal year 2006. This reclassification to return of capital had no impact on the Fund's net asset value.

At July 31, 2006, the investment in Vitality consisted of 500,000 shares of common stock at a cost of \$5 million and 1,000,000 shares of Series A convertible preferred stock at a cost of \$9.88 million. The increase in the cost and fair value of the Series A convertible preferred stock is due to the capitalization of payment in kind dividends. These increases were approved by the Fund's Valuation Committee. The common stock, Series A convertible preferred stock and warrants were assigned fair values of \$8.5 million, \$10.92 million and \$1.1 million, respectively. David Hadani, an employee of the Fund, serves as a director of Vitality.

### ***Yaga, Inc.***

Yaga, Inc. ( Yaga ), San Francisco, California, provided a hosted application service provider (ASP) platform that is designed to address emerging revenue and payment infrastructure needs of online businesses. Yaga's payment and accounting application supports micropayments, aggregated billing and stored value accounts while also managing royalty/affiliate accounting and split payments.

At October 31, 2005, the Fund's investment in Yaga consisted of 300,000 shares of Series A preferred stock and 1,000,000 shares of Series B with a combined cost of \$2.3 million. The investments had been assigned a fair value of \$0.

During the quarter ended January 31, 2006, the Fund received notification of the final dissolution of Yaga. The Fund received no proceeds from the dissolution of this company and the investment has been removed from the Fund's books. The fair value of Yaga was previously written down to zero and therefore, the net effect of the removal of Yaga from the Fund's books on the Fund's consolidated statement of operations and NAV was zero.

At July 31, 2006, the Fund no longer held any investment in Yaga.

**Table of Contents****Liquidity and Capital Resources**

At July 31, 2006, the Fund had investments in portfolio companies totaling \$212.2 million. Also, at July 31, 2006, the Fund had investments in short-term securities totaling approximately \$79.2 million and cash investments totaling approximately \$10.5 million. The Fund considers all money market and other cash investments purchased with an original maturity of less than three months to be cash equivalents. U.S. government securities and cash equivalents are highly liquid.

During the nine month period ended July 31, 2006, the Fund made twelve new investments, committing capital totaling approximately \$91.9 million. The investments were made in Turf, SOI, Henry, BM Auto, Storage Canada, Phoenix, Harmony Pharmacy, Total Safety, PreVisor, Marine, BP, and Velocitius. The amounts invested were \$11.6 million, \$5.0 million, \$5.0 million, \$15.0 million, \$6.0 million, \$8.0 million, \$200,000, \$6.0 million, \$6.0 million, \$14.0 million, \$15.0 million, and \$66,290, respectively.

The Fund also made six follow-on investments in existing portfolio companies committing capital totaling approximately \$9.5 million. During the nine month period ended July 31, 2006, the Fund invested approximately \$879,000 in Dakota by purchasing an additional 172,104 shares of common stock at an average price of \$5.11 per share. On December 22, 2005, the Fund extended to Baltic a \$1.8 million revolving bridge note. Baltic immediately drew down \$1.5 million from the note. On January 12, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The note matured on January 31, 2006 and has been removed from the Fund's books. On January 12, 2006, the Fund extended to SGDA a \$300,000 bridge loan. On March 28, 2006, the Fund extended to Baltic a \$2.0 million revolving bridge note. Baltic immediately drew down \$2.0 million from the note. On April 5, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The note matured on April 30, 2006 and has been removed from the Fund's books. On April 6, 2006, the Fund invested an additional \$2.0 million into SGDA in the form of a preferred equity interest. On April 25, 2006, the Fund purchased an additional common equity interest in SGDA for \$20,000. On June 30, 2006, the Fund invested in Amersham Corporation \$2.5 million in the form of a second lien loan. Current balance sheet resources, which include the additional cash resources from the Credit Facility II, are believed to be sufficient to finance the Fund's current commitments. Current commitments include:

***Commitments to/for Portfolio Companies:*****Open Commitments of MVC Capital, Inc.**

<b>Portfolio Company</b>	<b>Amount Committed</b>	<b>Balance Outstanding at July 31, 2006</b>
Octagon	\$ 5.0 million	
SGDA	\$ 1.6 million	\$ 1.6 million
Timberland	\$ 3.25 million	\$ 2.96 million
Storage Canada	\$ 6.0 million	\$ 1.34 million
Marine	\$ 2.0 million	

On May 7, 2004, the Fund provided a \$5,000,000 senior secured credit facility to Octagon. This credit facility expires on May 6, 2007 and can be automatically extended until May 6, 2009. The credit facility bears annual interest at LIBOR plus 4%. The Fund receives a 0.50% unused facility fee on an annual basis and a 0.25% servicing fee on an annual basis for maintaining the credit facility. On February 1, 2006, Octagon drew \$250,000 from the credit facility. The credit facility was repaid in full including, all accrued interest on February 23, 2006. As of July 31, 2006, no borrowings were outstanding.

During February 2005, the Fund made available to SGDA, a \$1,308,300 revolving credit facility that bears annual interest at 7%. The credit facility expires on August 25, 2006. During fiscal year 2006, SGDA drew down \$70,600 from the credit facility. On April 28, 2006, the Fund increased the availability under the revolving credit facility by \$300,000. The balance of the Fund's bridge loan to SDGA, which would have matured on April 30, 2006, was added to the revolving credit facility and the bridge loan was removed from the Fund's books. As of July 31, 2006, the entire \$1.6 million facility was drawn in full.

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On July 8, 2005 the Fund extended Timberland a \$3.25 million junior revolving note that bears interest at 12.5% per annum and expires on July 7, 2007. The Fund also receives a fee of 0.25% on the unused portion of the note. As of October 31, 2005, the total amount outstanding on the note was \$3.25 million. On December 27, 2005, the Fund exchanged \$286,200 of the Timberland junior revolving line of credit for 28.62 shares of common stock at a price of \$10,000 per share. As a result, the Fund now owns 478.62 common shares and the funded debt under the junior revolving line of credit has been reduced from \$3.25 million to approximately \$2.96 million. On April 21, 2006, Timberland repaid \$500,000 on the note. On May 18, 2006, Timberland repaid an additional \$500,000 on the note. On July 10, 2006, Timberland drew down \$1.0 million leaving the total amount on the note outstanding at July 31, 2006 approximately \$2.96 million.

On June 30, 2005, the Fund pledged its common stock of Ohio to Guggenheim to collateralize a loan made by Guggenheim to Ohio.

On December 22, 2005, the Fund extended to Baltic a \$1.8 million revolving bridge note. The note bears interest at 12% per annum and had a maturity date of January 31, 2006. Baltic immediately drew \$1.5 million from the note. On January 12, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The revolver matured on January 31, 2006 and has been removed from the Fund's books.

On March 28, 2006, the Fund extended to Baltic a \$2.0 million revolving bridge note. Baltic immediately drew down \$2.0 million from the note. On April 5, 2006, Baltic repaid the amount drawn from the note in full including all unpaid interest. The note matured on April 30, 2006 and has been removed from the Fund's books.

On March 30, 2006, the Fund provided a \$6 million loan commitment to Storage Canada and the company immediately borrowed \$1.34 million. The commitment expires after one year, but may be renewed with the consent of both parties. The initial borrowing on the loan bears annual interest at 8.75% and has a maturity date of March 30, 2013. Any additional borrowings will mature seven years from the date of the subsequent borrowing. The Fund also receives a fee of 0.25% on the unused portion of the loan.

On July 11, 2006, the Fund extended to Marine a \$2.0 million secured revolving note. The note bears annual interest at LIBOR plus 1%. The Fund also receives a fee of 0.50% of the unused portion of the loan. There was no amount drawn on the revolving note as of July 31, 2006.

Timberland also has a floor plan financing program administered by Transamerica. As is typical in Timberland's industry, under the terms of the dealer financing arrangement, Timberland guarantees the repurchase of product from Transamerica, if a dealer defaults on payment and the underlying assets are repossessed. The Fund has agreed to be a limited co-guarantor for up to \$500,000 on this repurchase commitment.

### ***Commitments of the Fund:***

On October 28, 2004, the Fund entered into a one-year, cash collateralized, \$20 million revolving credit facility (Credit Facility I) with LaSalle Bank National Association (the Bank). On July 20, 2005, the Fund amended Credit Facility I. The maximum aggregate loan amount under Credit Facility I was increased from \$20 million to \$30 million. Additionally, the maturity date was extended from October 31, 2005 to August 31, 2006. All other material terms of Credit Facility I remained unchanged. On January 27, 2006, the Fund borrowed \$10 million under Credit Facility I. The \$10 million borrowed under Credit Facility I was repaid in full by February 3, 2006. Borrowings under Credit Facility I bear interest, at the Fund's option, at either a fixed rate equal to the LIBOR rate (for one, two, three or six months), plus 1.00% per annum, or at a floating rate equal to the Bank's prime rate in effect from time to time, minus 1.00% per annum. As of July 31, 2006, there were no borrowings outstanding under Credit Facility I.

On February 16, 2005, the Fund entered into a sublease (the "Sublease") for a larger space in the building in which the Fund's current executive offices are located. The Sublease is scheduled to expire on February 28, 2007. Future payments under the Sublease total approximately \$55,500 in fiscal year 2006 and \$75,000 in fiscal year 2007. The Fund's previous lease was terminated effective March 1, 2005, without penalty. The building in which the Fund's executive offices are located, 287 Bowman Avenue, is owned by Phoenix Capital Partners, LLC, an entity which is 97% owned by Mr. Tokarz. See Note 7 "Management" for more information on Mr. Tokarz.

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On April 27, 2006, the Fund and MVCFS, as co-borrowers entered into a new four-year, \$100 million revolving credit facility ( Credit Facility II ) with Guggenheim as administrative agent to the lenders. On April 27, 2006, the Fund borrowed \$45 million (\$27.5 million drawn from the revolving credit facility and \$17.5 million in term debt) under Credit Facility II. The \$27.5 million drawn from the revolving credit facility was repaid in full on May 2, 2006. On July 28, 2006, the Fund borrowed \$57.5 million (\$45.0 million drawn from the revolving credit facility and \$12.5 million in term debt) under Credit Facility II. As of July 31, 2006, there was \$30.0 million in term debt and \$45.0 million on the revolving credit facility outstanding. The proceeds from borrowings made under Credit Facility II are expected to be used to fund new and existing portfolio investments, pay fees and expenses related to the financing and for general corporate purposes. Credit Facility II will expire on April 27, 2010, at which time all outstanding amounts under Credit Facility II will be due and payable. Borrowings under Credit Facility II will bear interest, at the Fund's option, at a floating rate equal to either (i) the LIBOR rate (for one, two, three or six months), plus a spread of 2.00% per annum, or (ii) the Prime rate in effect from time to time, plus a spread of 1.00% per annum. The Fund paid a closing fee, legal and other costs associated with this transaction. These costs will be amortized evenly over the life of the facility. The prepaid expenses on the Balance Sheet include the unamortized portion of these costs. Borrowings under Credit Facility II will be secured by, among other things, cash, cash equivalents, debt investments, accounts receivable, equipment, instruments, general intangibles, the capital stock of MVCFS, and any proceeds from all the aforementioned items, as well as all other property except for equity investments made by the Fund.

The Fund enters into contracts with portfolio companies and other parties that contain a variety of indemnifications. The Fund's maximum exposure under these arrangements is unknown. However, the Fund has not experienced claims or losses pursuant to these contracts and believes the risk of loss related to indemnifications to be remote.

## **Subsequent Events**

On August 2, 2006, the Fund repaid the \$45.0 million borrowed on the revolving credit facility under Credit Facility II.

On August 7, 2006, the Fund made a follow on equity investment in Harmony Pharmacy, investing \$750,000 for 2 million shares of common stock. Harmony is an operator of pharmacy and healthcare centers primarily in airports in the United States.

On August 16, 2006, the Fund consummated a leveraged buyout of Summit Research Labs, Inc. ( Summit ) a Huguenot, NY based specialty chemical company that manufactures antiperspirant actives. The Fund's investment in Summit consists of \$11.2 million in equity and \$5.0 million second lien loan. The second lien loan bears annual interest at 14% and matures August 15, 2012.

On August 25, 2006, Harmony Pharmacy repaid their \$200,000 demand note in full including all accrued interest.

On August 25, 2006, SGDA's revolving credit facility of approximately \$1.6 million was added to the term loan with an outstanding balance of approximately \$4.6 million. The total outstanding balance of the term loan is now approximately \$6.2 million. The line of credit was removed from the Fund's books as part of this transaction.

On August 31, 2006, the revolving credit facility with LaSalle Bank National Association, Credit Facility I, expired.

The Fund's annual meeting of shareholders is scheduled to be held on September 7, 2006. At the meeting, shareholders will be asked to: (i) elect five nominees to serve as members of the board of directors; and (ii) approve the Proposed Agreement. A definitive proxy statement relating to the meeting was filed with the SEC on August 3, 2006.

## **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Historically the Fund has invested in small companies, and its investments in these companies are considered speculative in nature. The Fund's investments often include securities that are subject to legal or contractual



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restrictions on resale that adversely affect the liquidity and marketability of such securities. As a result, the Fund is subject to risk of loss which may prevent our shareholders from achieving price appreciation, dividend distributions and return of capital.

Financial instruments that subjected the Fund to concentrations of market risk consisted principally of equity investments, subordinated notes, and debt instruments, which represent approximately 69.34% of the Fund's total assets at July 31, 2006. As discussed in Note 5 Portfolio Investments, these investments consist of securities in companies with no readily determinable market values and as such are valued in accordance with the Fund's fair value policies and procedures. The Fund's investment strategy represents a high degree of business and financial risk due to the fact that the investments (other than cash equivalents) are generally illiquid, in small and middle market companies, and include entities with little operating history or entities that possess operations in new or developing industries. These investments, should they become publicly traded, would generally be: (i) subject to restrictions on resale, if they were acquired from the issuer in private placement transactions; and (ii) susceptible to market risk. At this time, the Fund's investments in short-term securities are in 90-day Treasury Bills, which are federally guaranteed securities, or other high quality, highly liquid investments. The Fund's cash balances, if not large enough to be invested in 90-day Treasury Bills or other high quality, highly liquid investments, are swept into designated money market accounts. In addition, the following risk factors relate to market risks impacting the Fund.

### ***Investing in private companies involves a high degree of risk.***

Our investment portfolio generally consists of loans to, and investments in, private companies. Investments in private businesses involve a high degree of business and financial risk, which can result in substantial losses and accordingly should be considered speculative. There is generally very little publicly available information about the companies in which we invest, and we rely significantly on the due diligence of the Fund's investment team to obtain appropriate information in connection with our investment decisions.

### ***Our investments in portfolio companies are generally illiquid.***

We generally acquire our investments directly from the issuer in privately negotiated transactions. Most of the investments in our portfolio (other than cash or cash equivalents) are typically subject to restrictions on resale or otherwise have no established trading market. We may exit our investments when the portfolio company has a liquidity event, such as a sale, recapitalization or initial public offering. The illiquidity of our investments may adversely affect our ability to dispose of equity and debt securities at times when it may be otherwise advantageous for us to liquidate such investments. In addition, if we were forced to immediately liquidate some or all of the investments in the portfolio, the proceeds of such liquidation could be significantly less than the current fair value of such investments.

### ***Substantially all of our portfolio investments are recorded at fair value and, as a result, there is a degree of uncertainty regarding the carrying values of our portfolio investments.***

Pursuant to the requirements of the 1940 Act, because our portfolio company investments do not have readily ascertainable market values, we record these investments at fair value in accordance with Valuation Procedures adopted by our board of directors.

At July 31, 2006, approximately 69.34% of our total assets represented portfolio investments recorded at fair value. There is no single standard for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistently applied valuation process for the types of investments we make. We specifically value each individual investment and record unrealized depreciation for an investment that we believe has become impaired, including

where collection of a loan or realization of an equity security is doubtful. Conversely, we will record unrealized appreciation if we have an indication (based on an objective development) that the underlying portfolio company has appreciated in value and, therefore, our equity security has also appreciated in value, where appropriate. Without a readily ascertainable market value and because of the inherent uncertainty of fair valuations, fair value of our investments may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

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Pursuant to our Valuation Procedures, our Valuation Committee (which is currently comprised of three Independent Directors) reviews, considers and determines fair valuations on a quarterly basis (or more frequently, if deemed appropriate under the circumstances). Any changes in valuation are recorded in the statements of operations as Net change in unrealized appreciation (depreciation) on investments.

***Economic recessions or downturns could impair our portfolio companies and harm our operating results.***

Many of the companies in which we have made or will make investments may be susceptible to economic slowdowns or recessions. An economic slowdown may affect the ability of a company to engage in a liquidity event. These conditions could lead to financial losses in our portfolio and a decrease in our revenues, net income and assets.

Our overall business of making private equity investments may be affected by current and future market conditions. The absence of an active mezzanine lending or private equity environment may slow the amount of private equity investment activity generally. As a result, the pace of our investment activity may slow, which could impact our ability to achieve our investment objective. In addition, significant changes in the capital markets could have an effect on the valuations of private companies and on the potential for liquidity events involving such companies. This could affect the amount and timing of any gains realized on our investments.

***Our borrowers may default on their payments, which may have an effect on our financial performance.***

We may make long-term unsecured, subordinated loans, which may involve a higher degree of repayment risk than conventional secured loans. We primarily invest in companies that may have limited financial resources and that may be unable to obtain financing from traditional sources. In addition, numerous factors may adversely affect a portfolio company's ability to repay a loan we make to it, including the failure to meet a business plan, a downturn in its industry or operating results, or negative economic conditions. Deterioration in a borrower's financial condition and prospects may be accompanied by deterioration in any related collateral.

***Our investments in mezzanine and other debt securities may involve significant risks.***

Our investment strategy contemplates investments in mezzanine and other debt securities of privately held companies.

Mezzanine investments typically are structured as subordinated loans (with or without warrants) that carry a fixed rate of interest. We may also make senior secured and other types of loans or debt investments. Our debt investments are typically not rated by any rating agency, but we believe that if such investments were rated, they would be below investment grade quality (rated lower than Baa3 by Moody's or lower than BBB- by Standard & Poor's, commonly referred to as "junk bonds"). Loans of below investment grade quality have predominantly speculative characteristics with respect to the borrower's capacity to pay interest and repay principal. Our debt investments in portfolio companies may thus result in a high level of risk and volatility and/or loss of principal.

***We may not realize gains from our equity investments.***

When we invest in mezzanine and senior debt securities, we may acquire warrants or other equity securities as well. We may also invest directly in various equity securities. Our goal is ultimately to dispose of such equity interests and realize gains upon our disposition of such interests. However, the equity interests we receive or invest in may not appreciate in value and, in fact, may decline in value. In addition, the equity securities we receive or invest in may be subject to restrictions on resale during periods in which it would be advantageous to resell. Accordingly, we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any other losses we experience.



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***Our investments in small and middle-market privately-held companies are extremely risky and you could lose your entire investment.***

Investments in small and middle-market privately-held companies are subject to a number of significant risks including the following:

*Small and middle-market companies may have limited financial resources and may not be able to repay the loans we make to them.* Our strategy includes providing financing to companies that typically do not have capital sources readily available to them. While we believe that this provides an attractive opportunity for us to generate profits, this may make it difficult for the borrowers to repay their loans to us upon maturity.

*Small and middle-market companies typically have narrower product lines and smaller market shares than large companies.* Because our target companies are smaller businesses, they may be more vulnerable to competitors' actions and market conditions, as well as general economic downturns. In addition, smaller companies may face intense competition, including competition from companies with greater financial resources, more extensive development, manufacturing, marketing and other capabilities, and a larger number of qualified managerial and technical personnel.

*There is generally little or no publicly available information about these privately-held companies.* Because we seek to make investments in privately-held companies, there is generally little or no publicly available operating and financial information about them. As a result, we rely on our investment professionals to perform due diligence investigations of these privately-held companies, their operations and their prospects. We may not learn all of the material information we need to know regarding these companies through our investigations.

*Small and middle-market companies generally have less predictable operating results.* We expect that our portfolio companies may have significant variations in their operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, may require substantial additional capital to support their operations, finance expansion or maintain their competitive position, may otherwise have a weak financial position or may be adversely affected by changes in the business cycle. Our portfolio companies may not meet net income, cash flow and other coverage tests typically imposed by their senior lenders.

*Small and middle-market businesses are more likely to be dependent on one or two persons.* Typically, the success of a small or middle-market company also depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of one or more of these persons could have a material adverse impact on our portfolio company and, in turn, on us.

*Small and middle-market companies are likely to have greater exposure to economic downturns than larger companies.* We expect that our portfolio companies will have fewer resources than larger businesses and an economic downturn may thus more likely have a material adverse effect on them.

*Small and middle-market companies may have limited operating histories.* We may make debt or equity investments in new companies that meet our investment criteria. Portfolio companies with limited operating histories are exposed to the operating risks that new businesses face and may be particularly susceptible to, among other risks, market downturns, competitive pressures and the departure of key executive officers.

***Investments in foreign debt or equity may involve significant risks in addition to the risks inherent in U.S. investments.***

Our investment strategy may result in some investments in debt or equity of foreign companies (subject to applicable limits prescribed by the 1940 Act). Investing in foreign companies can expose us to additional risks not typically associated with investing in U.S. companies. These risks include exchange rates, changes in exchange control regulations, political and social instability, expropriation, imposition of foreign taxes, less liquid markets and less available information than is generally the case in the United States, higher transaction costs, less government supervision of exchanges, brokers and issuers, less developed bankruptcy laws, difficulty in enforcing contractual obligations, lack of uniform accounting and auditing standards and greater price volatility.

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***The market for private equity investments can be highly competitive. In some cases, our status as a regulated business development company may hinder our ability to participate in investment opportunities.***

We face competition in our investing activities from private equity funds, other business development companies, investment banks, investment affiliates of large industrial, technology, service and financial companies, small business investment companies, wealthy individuals and foreign investors. As a regulated business development company, we are required to disclose quarterly the name and business description of portfolio companies and the value of any portfolio securities. Many of our competitors are not subject to this disclosure requirement. Our obligation to disclose this information could hinder our ability to invest in certain portfolio companies. Additionally, other regulations, current and future, may make us less attractive as a potential investor to a given portfolio company than a private equity fund not subject to the same regulations. Furthermore, some of our competitors have greater resources than we do. Increased competition would make it more difficult for us to purchase or originate investments at attractive prices. As a result of this competition, sometimes we may be precluded from making certain investments.

***Our common stock price can be volatile.***

The trading price of our common stock may fluctuate substantially. The price of the common stock may be higher or lower than the price you pay for your shares, depending on many factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include the following:

price and volume fluctuations in the overall stock market from time to time;

significant volatility in the market price and trading volume of securities of business development companies or other financial services companies;

volatility resulting from trading in derivative securities related to our common stock including puts, calls, long-term equity participation securities, or LEAPs, or short trading positions;

changes in regulatory policies or tax guidelines with respect to business development companies or RICs;

actual or anticipated changes in our earnings or fluctuations in our operating results or changes in the expectations of securities analysts;

general economic conditions and trends;

loss of a major funding source; or

departures of key personnel.

***We are subject to market discount risk.***

As with any stock, the price of our shares will fluctuate with market conditions and other factors. If shares are sold, the price received may be more or less than the original investment. Whether investors will realize gains or losses upon the sale of our shares will not depend directly upon our NAV, but will depend upon the market price of the shares at the time of sale. Since the market price of our shares will be affected by such factors as the relative demand for and supply of the shares in the market, general market and economic conditions and other factors beyond our control, we cannot predict whether the shares will trade at, below or above our NAV. Although our shares have recently traded at a premium to our NAV, historically, our shares, as well as those of other closed-end investment companies, have frequently traded at a discount to their NAV, which discount often fluctuates over time.

***Changes in interest rates may affect our cost of capital and net investment income.***

Because we may borrow money to make investments, our net investment income before net realized and unrealized gains or losses, or net investment income, may be dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. In periods of sharply rising interest rates, our cost of funds would increase, which could reduce our net investment income. We may use a combination of long-term and short-term borrowings and equity capital to finance our



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investing activities. We may utilize our short-term credit facilities as a means to bridge to long-term financing. Our long-term fixed-rate investments are financed primarily with equity and long-term fixed-rate debt. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act.

***The war with Iraq, terrorist attacks, the Middle East crisis and other acts of violence or war may affect any market for our common stock, impact the businesses in which we invest and harm our operations and our profitability.***

The war with Iraq, its aftermath and the continuing occupation of Iraq are likely to have a substantial impact on the U.S. and world economies and securities markets. The nature, scope and duration of the war and occupation cannot be predicted with any certainty. Furthermore, terrorist attacks may harm our results of operations and your investment. We cannot assure you that there will not be further terrorist attacks against the United States or U.S. businesses. Such attacks and armed conflicts in the United States or elsewhere may impact the businesses in which we invest directly or indirectly, by undermining economic conditions in the United States. Losses resulting from terrorist events are generally uninsurable.

## **Item 4. Controls and Procedures**

(a) As of the end of the period covered by this quarterly report on Form 10-Q, the individual who performs the functions of a Principal Executive Officer (the CEO) and the individual who performs the functions of a Principal Financial Officer (the CFO) conducted an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934, as amended). Based upon this evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective in timely alerting them of any material information relating to us that is required to be disclosed by us in the reports it files or submits under the Securities Exchange Act of 1934, as amended.

(b) There have been no changes in our internal control over financial reporting that occurred during the quarter ended July 31, 2006, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **Part II. Other Information**

## **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

During the nine months ended July 31, 2006, we issued a total of 5,462 shares of common stock under our Plan pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended. The aggregate offering price for the shares of common stock sold under the Plan was approximately \$62,240.

## **Item 6. Exhibits**

(a) *Exhibits*

<b>Exhibit No.</b>	<b>Exhibit</b>
31	Rule 13a-14(a) Certifications.
32	Section 1350 Certification.

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Other required Exhibits are included in this Form 10-Q or have been previously filed with the Securities and Exchange Commission (the SEC) in the Fund's Registration Statements on Form N-2 (Reg. Nos. 333-119625 and 333-125953), the Fund's Annual Report on Form 10-K for the year ended October 31, 2005, as filed with the Securities and Exchange Commission (the SEC) on December 22, 2005 (File No. 814-00201) or the Fund's Quarterly Report on Form 10-Q for the quarter ended April 30, 2006, as filed with the SEC on June 9, 2006.

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Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed by the undersigned, thereunto duly authorized.

MVC Capital, Inc.

By: /s/ Michael Tokarz

Michael Tokarz

In the capacity of the officer who performs the functions of Principal Executive Officer.

Date: September 6, 2006

MVC Capital, Inc.

By: /s/ Peter Seidenberg

Peter Seidenberg

In the capacity of the officer who performs the functions of Principal Financial Officer.

Date: September 6, 2006