SOURCE CAPITAL INC /DE/
Form N-CSRS
August 28, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-1731

SOURCE CAPITAL, INC.
(Exact name of registrant as specified in charter)

11400 WEST OLYMPIC BLVD., SUITE 1200, LOS ANGELES, CALIFORNIA 90064
(Address of principal executive offices) (Zip code)

J. RICHARD ATWOOD,
11400 WEST OLYMPIC BLVD., SUITE 1200, LOS ANGELES, CALIFORNIA 90064
(Name and address of agent for service)

Registrant s telephone number, including area code: 310-473-0225

Date of fiscal year end: DECEMBER 31

Date of reporting period: JUNE 30, 2007

Item 1. Report to Stockholders

SOURCE CAPITAL, INC.

SEMIANNUAL REPORT

for the six months ended June 30, 2007

SUMMARY FINANCIAL INFORMATION

	Six months ended June 30, 2007		Year ended December 31, 2006	
	Total Net Assets	Per Common Share	Total Net Assets	Per Common Share
Beginning of period	$ 610,486,274	$ 64.81	$ 619,973,031	$ 66.79
Net gain on investments, realized and unrealized	$ 60,162,394	$ 6.98	$ 24,244,767	$ 2.86
Net investment income	3,434,086	0.40	3,784,171	0.44
Dividends to Preferred shareholders	(2,363,054)	(0.27)	(4,726,109)	(0.56)
Distributions to Common shareholders	(17,194,258)	(2.00)	(40,346,643)	(4.74)
Proceeds from Common shares issued for distributions reinvested by shareholders	3,169,980		7,557,057	0.02
Net changes during period	$ 47,209,148	$ 5.11	$ (9,486,757)	$ (1.98)
End of period	$ 657,695,422	$ 69.92	$ 610,486,274	$ 64.81

	June 30, 2007	December 31, 2006	December 31, 2005
Common market price per share	$ 68.75	$ 67.59	$ 73.75
Common market premium (discount) to net asset value	(1.7)%	4.3%	10.4%
Preferred asset coverage	1,215%	1,127%	1,145%
Preferred liquidation preference per share	$ 27.50	$ 27.50	$ 27.50
Preferred market price per share	$ 32.24	$ 31.85	$ 33.60

DESCRIPTION OF THE COMPANY

Source Capital, Inc., is a major diversified, publicly traded investment company with total net assets approximating $658,000,000. Its investment portfolio includes a wide range of securities with primary emphasis on common stocks.

Source Capital has Common and Preferred shares outstanding, both of which are traded on The New York Stock Exchange. Each of the 1,969,212 outstanding Preferred shares has a prior claim of $27.50 on assets and $2.40 per year on income. The balance of the Company's assets and income are available to the 8,632,436 shares of Common Stock outstanding.

Source Capital's investment objective is to seek maximum total return for Common shareholders from both capital appreciation and investment income to the extent consistent with protection of invested capital and provision of sufficient income to meet the dividend requirements of Preferred shareholders.

Source Capital is not a mutual fund. Thus, it does not repurchase its own shares on demand and does not need to structure its portfolio securities to provide for possible redemptions. As a publicly traded investment company, Source Capital's Common and Preferred shares are bought and sold on The New York Stock Exchange, and the Company is not involved in the transaction.

Source Capital's investment approach emphasizes primarily equity and equity-related investments in seeking to achieve its growth objective for its Common shareholders. The desirability of equity versus fixed-income investments continues to be a subject of debate. Source Capital's position is that without assuming undue risk and recognizing the fixed claim of its Preferred Stock, properly selected stocks offer the better long-term opportunity for overall investment return as well as long-term protection from the large but uncertain threat of inflation. Source Capital's equity investments have been directed toward companies with highly liquid, relatively unleveraged balance sheets, and a demonstrated long-term ability to earn above-average returns on invested capital. Source Capital's equity investment portfolio is based on fundamental judgments of long-term returns attainable from income and appreciation in the securities of such companies and is not derived from overall economic forecasts or stock market predictions.

The Company has adopted a flexible distribution policy. This policy is designed to pay Common shareholders quarterly distributions at a rate that is substantially in excess of net investment income. The rate will be adjusted periodically in response to sustained changes in the net asset value, market conditions, and changes to investment company regulations and tax laws. Only a portion of such distributions is paid from net investment income. The remainder is paid from any net realized capital gains and/or paid-in capital, as determined by each year's results. To the extent the Company realizes net long-term capital gains for any year in excess of the amounts distributed under the Company's distribution policy, such excess will be distributed to shareholders. All distributions are taxable to shareholders as dividend income or capital gain distributions since the Company has accumulated earnings and profits from prior years.

LETTER TO SHAREHOLDERS

TO OUR SHAREHOLDERS:

Source Capital's total net assets increased from $605,487,484 to $657,695,422 during the second quarter. Net asset value per Common share amounted to $69.92 at June 30, 2007, compared with $64.04 at March 31, 2007, and $64.81 at year-end 2006. These changes in net asset value were net of cash distributions of $1.00 paid in both the first and second quarters.

Investment Results, 2007 First Half

For the six months ended June 30, 2007, the net asset value per share of Source Capital's Common Stock increased by 11.1%, as adjusted for reinvestment of distributions paid during the period, while total net assets rose 10.6%. These returns compare with an 8.7% increase in the Russell 2500 Index, a measure of small to medium capitalization stock performance. The foregoing changes were calculated on the basis of reinvesting all dividends and distributions.

Investment Results, 2007 Second Quarter

In the most recent quarter, Source Capital's net asset value per share of Common Stock increased 10.8%, as adjusted for reinvestment of the $1.00 distribution paid during the period, while total net assets rose 10.0%, both on a reinvestment basis. In comparison, the Russell 2500 Index increased 4.9% during the quarter, also on a reinvestment basis.

Distributions to Common Shareholders

A regular quarterly distribution of $1.00 per share was paid on June 15, 2007, to shareholders of record on May 25, 2007. Source Capital's distribution policy allows the Board of Directors to continue to consider changes in net asset value when establishing the quarterly distribution rate, but also provides the flexibility to consider other factors such as current market conditions and changes to investment company regulations and tax laws. It is the intention of the Board of Directors to continue paying quarterly distributions at a rate that is substantially in excess of net investment income as evidenced by the current annual distribution rate of $4.00.

Preferred Dividends

The regular Preferred dividend of $0.60 per share was paid on June 15, 2007, to shareholders of record on May 25, 2007. The changes in the Company's total net assets since year-end 2006 have resulted in changes in the Preferred shares' asset coverage from 1,127% at December 31, 2006 to 1,118% at March 31, 2007, and 1,215% at June 30, 2007. Net investment income provided Preferred dividend coverage of 238% for the second quarter and 145% for the six months, compared with 107% and 93% for the corresponding periods of 2006.

Market Price of Source Capital Shares

The market price of Source Capital Common Stock increased from $67.59 to $68.75 during the first half of 2007. As this $1.16 increase in market price was less than the $5.11 increase in the underlying net asset value, the market premium to net asset value of 4.3% at year-end 2006 reversed to a discount of 1.7% at June 30, 2007. The market price of Source Capital Preferred Stock increased to $32.24 at June 30, 2007, from $31.85 at year-end 2006.

Commentary

The stock market continued its dynamic advance, which began 4$^1/_2$ years ago in 2003, with first-half gains of 6.5% for the Russell 2000 and 7% for the S&P 500, both of which represent strong double-digit rates on an annualized basis. Since the start of 2003, the Russell 2000 has advanced at a rate of 20% per year, the S&P 500 at a 15% rate.

Source has done gratifyingly well so far in 2007, with much of that gain coming in the second quarter. First-half returns were 11.1% for Source, more than two points ahead of the benchmark Russell 2500, and 3-4 points above other indexes. Over longer time periods, Source has been very competitive with the Russell 2500 and achieved double the 10-year annual return of the S&P 500, the index which best represents the market as a whole.

	Periods Ended June 30, 2007				
	Second Quarter	**First Half**	**Three Years***	**Five Years***	**Ten Years***
Source	10.8%	11.1%	13.2%	15.3%	14.3%
Russell 2500	4.9%	8.7%	15.0%	15.3%	11.0%
S&P 500	6.3%	7.0%	11.7%	10.7%	7.1%
Nasdaq	7.5%	7.8%	8.3%	12.2%	6.1%

* Annualized Returns.

Source's strong first-half performance was driven by its position in oil services (Noble, Helix and Tidewater, up over 30%), companies supporting pharmaceutical research (Invitrogen and Charles River Labs, up 25%), and CDW, a direct marketer of technology products, mostly to small businesses (+20%).

In the past two Source Capital shareholder letters we discussed the impact of private-equity funds on stock performance. At year-end 2006, we argued that private equity's preference for low- and medium-quality businesses had contributed to the poor relative performance in 2006 of Source's high-quality, efficiently managed portfolio companies. We also made the points that we would not change our investment philosophy and we would continue to emphasize the same high-quality businesses for the Source portfolio as in the past. In the first-quarter letter we were more upbeat and expressed the view that this baleful influence on the market would eventually dissipate, though the timing remained unclear. We continue to think this is the case and, in fact, believe that "eventually" is "now."

There are a number of reasons we take this view. First, although private equity funding continues at high rates, there is no evidence of a significant increase versus last year, which we believe is a prerequisite to continued relative underperformance. Second, we have not seen an increase in deal pricing.

Third, credit spreads have noticeably increased. This means that the interest rate which the private-equity buyer must pay on the debt portion of his highly leveraged purchase is higher. In addition, the appetite of bond buyers for deal paper has clearly diminished. Recently, several financings have been withdrawn or postponed, including Chrysler, Allison Transmission, Service

Master, Expedia, and Dollar General, as buyers have demanded higher rates and more rigorous bond covenants. These trends are likely to make deals harder to do and, potentially, to lower prices.

Finally, private-equity investors have been seeking larger-size target companies. If this continues, as we expect it will, it may have some modest impact on large-cap valuations but, more importantly, will most likely reduce the impact of private equity on the small- and mid-cap universe that is more relevant to the Source portfolio.

The price increase in **CDW**, which we noted above, was in part the result of an acquisition agreement with Madison Dearborn Partners, a Chicago private-equity firm. Madison Dearborn will pay $87.75 in cash for each CDW share. We viewed this announcement with mixed feelings. Although an eight-point premium over CDW's recent price was clearly positive, we also believed that we would be far better off, and would achieve much more attractive returns on our investment, as a long-term owner of a publicly traded CDW.

We had first purchased CDW in early 2005 and gradually added to our position at prices mostly in the mid- to low-50s. By the end of 2006, CDW was a 4.5% portfolio position, our sixth largest. The opportunity to increase our position at attractive prices was driven in part by several challenges in the business, which CDW needed some time to master. These included capacity expansion (a new warehouse and a big increase in office space), a large acquisition, and a major sales force reorganization.

The sales force reorganization assigned most of CDW's corporate sales reps to defined geographic regions and involved the transfer of many thousands of accounts. It was instituted in March 2006, and perhaps unsurprisingly followed by several quarters of disappointingly flat sales. However, starting this past March, the tide decisively turned, and CDW's corporate sector began posting dramatically better results sales growth of 10-12% each month.

CDW purchased Berbee in October 2006, its largest acquisition ever. Berbee is a reseller of advanced technology products, including network infrastructure, communication systems, storage, and security. It gave CDW access to new product areas and the opportunity to do significant cross selling with its established customers. In addition, with offices in only six Midwestern states, Berbee had considerable expansion potential, either de novo or by acquisition of resellers with similar strategies and products. Early Berbee results have been extraordinarily good, with sales growth averaging +60% for the first and second quarters.

This combination of improved sales to the corporate sector and impressive performance at Berbee produced very strong earnings performance in the first quarter with operating margins up 30 basis points and EPS increasing by 28%, results well above market expectations. Not surprisingly, CDW's stock reacted very favorably to these dramatic improvements in sales, and earnings, rising from $58 a share in early March to $80 in early May, up 38%.

We were, therefore, surprised and shocked to learn in late May that CDW's Board of Directors had agreed to the sale of the company to Madison Dearborn at the price of $87.75, a nominal 10% premium over its recent high. As we discussed above, CDW was in the relatively early stages of emerging from a period of significant investment in its business the new distribution center in Las Vegas, expanded office space in Chicago, the $180-million Berbee acquisition, and a painful, but ultimately successful sales force re-organization. There is little doubt in our mind that the buyer will be capturing most of the future benefits of these actions, leaving shareholders poorly compensated for their patience in owning the stock for the past two years.

We will be voting against the merger at the scheduled August 9 shareholders meeting.

Respectfully submitted,

Eric S. Ende

President and
Chief Investment Officer

July 27, 2007

The discussion of Company investments represents the views of the Company's managers at the time of this report and are subject to change without notice. References to individual securities are for informational purposes only and should not be construed as recommendations to purchase or sell individual securities. While the Company's managers believe that the Company's holdings are value stocks, there can be no assurance that others will consider them as such. Further, investing in value stocks presents the risk that value stocks may fall out of favor with investors and underperform growth stocks during given periods.

The Russell 2000 Index is an unmanaged index comprised of the 2,000 smallest companies in the Russell 3000 Index. The Russell 2500 Index is an unmanaged index comprised of the 2,500 smallest companies in the Russell 3000 Index. The Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization. The S&P 500 Index is an index of 500 companies with large market capitalization. The Dow Jones Industrial Average (DJIA) covers 30 major companies. The Lehman Brothers Government/Credit Index is a broad-based unmanaged index of all government and corporate bonds that are investment grade with at least one year to maturity. The Nasdaq Composite Index is a market capitalization index comprised of over 3,000 stocks.

FORWARD LOOKING STATEMENT DISCLOSURE

As managers, one of our responsibilities is to communicate with shareholders in an open and direct manner. Insofar as some of our opinions and comments in our letters to shareholders are based on current management expectations, they are considered "forward-looking statements," which may or may not be accurate over the long term. While we believe we have a reasonable basis for our comments and we have confidence in our opinions, actual results may differ materially from those we anticipate. You can identify forward-looking statements by words such as "believe," "expect," "may," "anticipate," and other similar expressions when discussing prospects for particular portfolio holdings and/or the markets, generally. We cannot, however, assure future results and disclaim any obligation to update or alter any forward-looking statements, whether as a result of new information, future events, or otherwise. Further, information provided in this report should not be construed as a recommendation to purchase or sell any particular security.

PORTFOLIO OF INVESTMENTS

June 30, 2007

COMMON STOCKS	Shares	Value
BUSINESS SERVICES & SUPPLIES 25.5%		
Brady Corporation	510,400	$ 18,956,256
CDW Corporation*	353,900	30,070,883
Charles River Laboratories International, Inc.*	455,000	23,487,100
Clarcor, Inc.	335,000	12,539,050
Copart, Inc.*	265,000	8,106,350
Invitrogen Corporation*	270,000	19,912,500
Manpower Inc.	300,000	27,672,000
ScanSource Inc.*	850,000	27,191,500
		$ 167,935,639
PRODUCER DURABLE GOODS 14.0%		
Franklin Electric Co., Inc.	220,000	$ 10,379,600
Graco Inc.	495,000	19,938,600
HNI Corporation	375,000	15,375,000
IDEX Corporation	742,500	28,615,950
Zebra Technologies Corporation (Class A)*	465,000	18,014,100
		$ 92,323,250
ENERGY 11.3%		
Helix Energy Solutions Group, Inc.*	695,000	$ 27,737,450
Noble Corporation	460,000	44,859,200
Tidewater Inc.	23,700	1,679,856
		$ 74,276,506
TECHNOLOGY 10.4%		
Cognex Corporation	720,000	$ 16,207,200
Maxim Integrated Products, Inc.	225,000	7,517,250
Microchip Technology, Inc.	380,000	14,075,200
Plantronics, Inc.	751,100	19,693,842
SanDisk Corporation*	215,000	10,522,100
		$ 68,015,592
RETAILING 9.7%		
CarMax, Inc.*	1,070,012	$ 27,285,306
O'Reilly Automotive, Inc.*	1,000,000	36,550,000
		$ 63,835,306
HEALTH CARE 6.6%		
Amsurg Corporation*	340,000	$ 8,207,600
Bio-Rad Laboratories, Inc. (Class A)*	200,300	15,136,671
Lincare Holdings Inc.*	510,000	20,323,500
		$ 43,667,771
TRANSPORTATION 4.8%		
Heartland Express, Inc.	1,050,000	$ 17,115,000
Knight Transportation, Inc.	731,900	14,184,222
		$ 31,299,222
FINANCIAL 4.2%		

Brown & Brown, Inc.	630,000	$	15,838,200
First American Corporation	235,000		11,632,500
		$	27,470,700
ENTERTAINMENT 4.0%			
Carnival Corporation	536,600	$	26,169,982
CONSUMER DURABLE GOODS 0.9%			
Polaris Industries, Inc.	110,900	$	6,006,344
TOTAL COMMON STOCKS 91.4% (Cost $330,740,178)		$	601,000,312

PORTFOLIO OF INVESTMENTS

June 30, 2007

PREFERRED STOCKS 1.6%	Shares or Face Amount	Value
REAL ESTATE INVESTMENT TRUST		
CBL & Associates Properties, Inc.	100,000	$ 2,514,000
Duke-Weeks Realty Corp. (Series B)	40,000	2,020,000
Pennsylvania Real Estate Investment Trust (Series A)	59,000	3,110,480
Prologis (Series G)	120,000	2,961,600
TOTAL PREFERRED STOCKS (Cost $10,179,446)		$ 10,606,080
CONVERTIBLE DEBENTURE 0.3% (Cost $1,970,000)		
TECHNOLOGY		
International Rectifier Corp. 4.25% 2007	$ 2,000,000	$ 1,995,000
NON-CONVERTIBLE BONDS AND DEBENTURES		
CORPORATE 2.8%		
Central Garden & Pet Company 9.125% 2013	$ 3,000,000	$ 3,075,000
Hanover Equipment Trust 8.5% 2008	2,000,000	2,005,000
Invacare Corporation 9.75% 2015	2,000,000	2,010,000
JLG Industries, Inc. 8.25% 2008	2,000,000	2,006,280
Manitowoc Company, Inc., The 10.5% 2012	1,300,000	1,374,750
PolyOne Corporation		
6.58% 2011	1,500,000	1,438,125
10.625% 2010	556,000	586,580
Realty Income Corporation 8.25% 2008	2,000,000	2,067,200
Titan International, Inc. 8% 2012	2,000,000	2,055,000
Unisys Corporation 7.875% 2008	1,500,000	1,507,500