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MUNIYIELD NEW JERSEY FUND INC

Form N-2

July 13, 2004

As filed with the Securities and Exchange Commission on July 13, 2004

Securities Act File No. 333-

Investment Company Act File No. 811-06570

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-2

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933 ☒

Pre-Effective Amendment No. ☐

Post-Effective Amendment No. ☐

and/or

REGISTRATION STATEMENT UNDER THE  
INVESTMENT COMPANY ACT OF 1940 ☒

AMENDMENT NO. 7 ☒

(Check appropriate box or boxes)

MUNIYIELD NEW JERSEY FUND, INC.  
(Exact Name of Registrant as Specified in Charter)

800 Scudders Mill Road, Plainsboro, New Jersey 08536  
(Address of Principal Executive Offices)

(Registrant's Telephone Number, Including Area Code) (609) 282-2800

Terry K. Glenn  
MuniYield New Jersey Fund, Inc.  
800 Scudders Mill Road, Plainsboro, New Jersey 08536  
Mailing Address: P.O. Box 9011, Princeton, New Jersey 08543-9011  
(Name and Address of Agent for Service)

Copies to:

Andrew J. Donohue, Esq.  
FUND ASSET MANAGEMENT, L.P.  
P.O. Box 9011  
Princeton, New Jersey 08543-9011

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787 Seventh Avenue  
New York, New York 10019-6018

Approximate date of proposed public offering: As soon as practicable  
after the effective date of this Registration Statement.

If any of the securities being registered on this form are to be offered  
on a delayed or continuous basis pursuant to Rule 415 under the Securities Act  
of 1933, as amended (the "Securities Act"), other than securities offered only  
in connection with dividend or interest reinvestment plans, check the  
following box. ☐

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## CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of Securities Being Registered	Amount being Registered (1)	Proposed Maximum Offering Price Per Unit (1)	Propose Aggregat Pri
Auction Market Preferred Stock.....	1,100 shares	\$25,000	\$27,

(1) Estimated solely for the purpose of calculating the registration fee.

(2) Transmitted prior to the filing date to the designated lockbox of the Securities and Exchange Commission at Mellon Bank in Pittsburgh, PA.

The Registrant hereby amends this Registration Statement on such date or dates as may become necessary to delay its effective date until the Registrant shall file a further amendment, which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to Completion  
Preliminary Prospectus dated July 13, 2004

PROSPECTUS

\$27,500,000

MuniYield New Jersey Fund, Inc.  
Auction Market Preferred Stock ("AMPS")

1,100 Shares, Series C

Liquidation Preference \$25,000 Per Share

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MuniYield New Jersey Fund, Inc. is a non-diversified, closed-end fund. The investment objective of the Fund is to provide shareholders with as high a level of current income exempt from Federal income taxes and New Jersey personal income tax as is consistent with its investment policies and prudent investment management. The Fund seeks to achieve its investment objective by investing, as a fundamental policy, at least 80% of an aggregate of the Fund's net assets (including proceeds from the issuance of any preferred stock) and the proceeds of any borrowings for investment purposes, in a portfolio of municipal obligations the interest on which, in the opinion of bond counsel to the issuer, is excludable from gross income for Federal income tax purposes (except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax) and exempt from New Jersey personal

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income tax. Under normal market conditions, the Fund invests primarily in long term municipal obligations that are rated investment grade or, if unrated, are considered by the Fund's investment adviser to be of comparable quality. The Fund may invest in certain tax exempt securities classified as "private activity bonds," as discussed within, that may subject certain investors in the Fund to an alternative minimum tax. There can be no assurance that the Fund's investment objective will be realized.

This prospectus contains information you should know before investing, including information about risks. Please read it before you invest and keep it for future reference. The Fund's statement of additional information, dated , 2004, contains further information about the Fund and is incorporated by reference (legally considered to be part of this prospectus) and the table of contents of the statement of additional information appears on page 47 of this prospectus. You may request a free copy by writing or calling the Fund at (800) 543-6217.

Certain capitalized terms used herein not otherwise defined in this prospectus have the meaning provided in the Glossary at the back of this prospectus.

Investing in the AMPS involves certain risks that are described in the "Risk Factors and Special Considerations" section beginning on page 7 of this prospectus. The minimum purchase amount for the AMPS is \$25,000.

	Per Share
Public offering price.....	\$25,000
Underwriting discount.....	\$250
Proceeds, before expenses, to the Fund (1)	\$24,750

(1) The estimated offering expenses payable by the Fund are \$135,000.

The public offering price per share will be increased by the amount of accumulated dividends, if any, from the date the shares are first issued.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

One certificate for the Series C AMPS will be ready for delivery to the nominee of The Depository Trust Company on or about , 2004.

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Merrill Lynch & Co.  
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The date of this prospectus is , 2004.

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Information about the Fund can be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-202-942-8090 for information on the operation of the public reference room. This information is also available on the SEC's Internet site at <http://www.sec.gov> and copies may be obtained upon payment of a duplicating fee by writing to the Public Reference Section of the SEC, Washington, D.C. 20549-0102.

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You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate only as of the date on the front cover of this prospectus. Our business, financial condition, results of operations and prospects may have changed since that date.

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PROSPECTUS SUMMARY

This summary is qualified in its entirety by reference to the detailed information included in this prospectus and the statement of additional information.

The Fund MuniYield New Jersey Fund, Inc. is a non-diversified, closed-end management investment company.

The Offering The Fund is offering a total of 1,100 shares of Auction Market Preferred Stock, Series C, at a purchase price of \$25,000 per share plus accumulated dividends, if any, from the date the shares are first issued. The shares of AMPS are being offered by Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), as underwriter.

The Series C AMPS will be shares of preferred stock of the Fund that entitle their holders to receive cash dividends at an annual rate that may vary for the successive dividend periods. In general, except as described below, each dividend period for the Series C AMPS following the initial dividend period will be seven days. The applicable dividend for a particular dividend period will be determined by an auction conducted on the business day next preceding the start of that dividend period.

Investors and potential investors in shares of Series C AMPS may participate in auctions for the AMPS through their broker-dealers.

Generally, AMPS investors will not receive certificates representing ownership of their shares. Ownership of AMPS will be maintained in book-entry form by the securities depository (The Depository Trust Company) or its nominee for the account of the investor's agent member (generally the investor's broker-dealer). The investor's agent member, in turn, will maintain records of such investor's beneficial ownership of AMPS.

Investment Objective and Policies The investment objective of the Fund is to provide shareholders with as high a level of current income exempt from Federal income taxes and New Jersey personal income tax as is consistent with its investment policies and prudent investment management. The Fund seeks to achieve its investment objective by investing, as a fundamental policy, at least 80% of an aggregate of the Fund's net assets (including proceeds from the issuance of any preferred stock) and the proceeds of any borrowings for investment purposes, in a portfolio of municipal obligations issued by or on behalf of the State of New Jersey, its political subdivisions, agencies and instrumentalities and by other qualifying issuers, each of which pays interest that, in the opinion of bond counsel to the issuer, is excludable from gross income for Federal income tax purposes (except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax) and

exempt from New Jersey personal income tax ("New Jersey Municipal Bonds"). The Fund also may invest in municipal obligations issued by or on behalf of states, territories and possessions of the United States and their political subdivisions, agencies or instrumentalities, each of which pays interest that, in the opinion of bond counsel to the issuer, is excludable from gross income for Federal income tax purposes but is not exempt from gross income for New Jersey personal income tax purposes ("Municipal Bonds"). In general, the Fund does not intend for its investments to earn a large amount of interest income that is not exempt from Federal income tax (except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax) or New Jersey personal income tax. There can be no assurance that the Fund's investment objective will be realized.

Investment Grade Municipal Bonds. Under normal market conditions, the Fund invests primarily in a portfolio of long term New Jersey Municipal Bonds and Municipal Bonds that are rated investment grade by one or more nationally recognized statistical rating organizations ("NRSROs") or in unrated bonds considered by Fund Asset Management,

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L.P., the Fund's investment adviser (the "Investment Adviser"), to be of comparable quality.

Indexed and Inverse Floating Rate Securities. The Fund may invest in securities whose potential returns are directly related to changes in an underlying index or interest rate, known as indexed securities. The return on indexed securities will rise when the underlying index or interest rate rises and fall when the index or interest rate falls. The Fund may also invest in securities whose return is inversely related to changes in an interest rate (inverse floaters). In general, income on inverse floaters will decrease when short term interest rates increase and increase when short term interest rates decrease. Investments in inverse floaters may subject the Fund to the risks of reduced or eliminated interest payments and loss of principal. In addition, certain indexed securities and inverse floaters may increase or decrease in value at a greater rate than the underlying interest rate, which effectively leverages the Fund's investment. As a result, the market value of such securities will generally be more volatile than that of fixed rate, tax exempt securities. Both indexed securities and inverse floaters are derivative securities and can be considered speculative.

Hedging Transactions. The Fund may seek to hedge its portfolio against changes in interest rates using options and financial futures contracts or swap transactions. The Fund's hedging transactions are designed to reduce volatility, but come at some cost. For example, the Fund may try to limit its risk of loss from a decline in price of a portfolio security by purchasing a put option. However, the Fund must pay for the option, and the price of the security may not in fact drop. In large part, the success of the Fund's hedging activities depends on its ability to forecast movements in securities prices and interest rates. The Fund is not required to hedge its portfolio and may choose not to do so. The Fund cannot guarantee that any hedging strategies it uses will work.

Swap Agreements. The Fund is authorized to enter into swap agreements, which are over-the-counter contracts in which one party agrees to make periodic payments based on the change in the market value of a specific bond, basket of bonds or index in return for periodic payments based on a fixed or variable interest rate or the change in market value of a different bond, basket of bonds or index. Swap agreements may be used to obtain exposure to a bond or market without owning or taking physical custody of securities.

Tax Considerations. While exempt interest distributions derived from interest or gains on New Jersey Municipal Bonds are excluded from gross income for Federal income tax and New Jersey personal income tax purposes (if certain requirements are met), they may be subject to the Federal alternative minimum tax in certain circumstances. Distributions of any capital gain or other taxable income will be taxable to stockholders. The Fund may not be a suitable investment for investors subject to the Federal alternative minimum tax or who would become subject to such tax by investing in the Fund. See "Taxes."

Investment Adviser

The Investment Adviser provides investment advisory and administrative services to the Fund. For its services, the Fund pays the Investment Adviser a monthly fee at the annual rate of 0.50% of the Fund's average weekly net assets (including any proceeds from the issuance of preferred stock).

Dividends and  
Dividend Periods

Dividends on the Series C AMPS will be cumulative from the date the shares are first issued and payable at the annualized cash dividend rate for the initial dividend period on the initial dividend payment date as follows:

	Initial Dividend Rate	Initial Dividend Period Ending
AMPS Series		
Series C.....	%	, 2004
<p>After the initial dividend period, each dividend period for the Series C AMPS will generally consist of seven days; provided however, that, before any auction, the Fund may decide, subject to certain limitations and only if it gives notice to holders, to declare a special dividend period of up to five years.</p> <p>After the initial dividend period, in the case of dividend periods that are not special dividend periods, dividends generally will be payable on each succeeding Tuesday in the case of the Series C AMPS.</p> <p>Dividends for the Series C AMPS will be paid through the securities depository (The Depository Trust Company) on each dividend payment date for the AMPS.</p> <p>For each subsequent dividend period, the auction agent (The Bank of New York) will hold an auction to determine the cash dividend rate on the shares of Series C AMPS.</p>		
Determination of Maximum Dividend Rates	<p>Generally, the applicable dividend rate for any dividend period for the Series C AMPS will not be more than the maximum applicable rate attributable to such shares. The maximum applicable rate will be the higher of (A) the applicable percentage of the reference rate on the auction date or (B) the applicable spread plus the reference rate on the auction date. The reference rate is (A) the higher of the applicable LIBOR Rate (as defined in the Glossary) and the Taxable Equivalent of the Short Term Municipal Bond Rate (as defined in the Glossary) (for a dividend period or special dividend period of 364 or fewer days), or (B) the applicable Treasury Index Rate (as defined in the Glossary) (for a special dividend period of 365 days or more). The maximum applicable rate for the Series C AMPS will depend on the credit rating assigned to the shares, the length of the dividend period and whether or not the Fund has given notification prior to the auction for the dividend period that any taxable income will be included in the dividend on the AMPS for that dividend period. The applicable percentage and applicable spread are as follows:</p>	
	Applicable	Applicable



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Credit Ratings		Percentage	Percentage
		of Reference Rate--No Notification	of Reference Rate-- Notification
Moody's	S&P		
Aaa	AAA	110%	125%
Aa3 to Aa1	AA- to AA+	125%	150%
A3 to A1	A- to A+	150%	200%
Baa3 to Baa1	BBB- to BBB+	175%	250%
Below Baa3	Below BBB-	200%	300%

The applicable percentage and the applicable spread as so determined may be subject to upward but not downward adjustment in the discretion of the Board of Directors of the Fund after consultation with the broker-dealers participating in the auction for the AMPS.

There is no minimum applicable dividend rate for any dividend period.

## Other AMPS

The Fund has outstanding 3,900 shares of two other series of Auction Market Preferred Stock, each with a liquidation preference of \$25,000 per share, plus accumulated but

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unpaid dividends, for an aggregate initial liquidation preference of \$97,500,000 (the "Other AMPS"). The Other AMPS are as follows: 2,400 shares of Auction Market Preferred Stock, Series A; and 1,500 shares of Auction Market Preferred Stock, Series B. The Series C AMPS offered hereby rank on a parity with the Other AMPS with respect to dividends and liquidation preference.

## Asset Maintenance

Under the Fund's Articles Supplementary creating the Series C AMPS (the "Articles Supplementary"), the Fund must maintain:

- o asset coverage of the AMPS and Other AMPS as required by the rating agencies rating the AMPS, and
- o asset coverage of the AMPS and Other AMPS of at least 200% as required by the Investment Company Act of 1940 (the "1940 Act").

The Fund estimates that, based on the composition of its portfolio at May 31, 2004, asset coverage of the AMPS and Other AMPS as required by the 1940 Act would be approximately [ ]% immediately after the Fund

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issues the shares of AMPS offered by this prospectus representing approximately [ ]% of the Fund's capital, or approximately [ ]% of the Fund's common stock equity, immediately after the issuance of such AMPS.

### Mandatory Redemption

If the required asset coverage is not maintained or, when necessary, restored, the Fund must redeem shares of AMPS at the price of \$25,000 per share plus accumulated but unpaid dividends thereon (whether or not earned or declared). The provisions of the 1940 Act may restrict the Fund's ability to make such a mandatory redemption.

### Optional Redemption

The Fund may, at its option, choose to redeem all or a portion of the shares of AMPS on any dividend payment date at the price of \$25,000 per share, plus accumulated but unpaid dividends thereon (whether or not earned or declared), plus any applicable premium.

### Liquidation Preference

The liquidation preference (that is, the amount the Fund must pay to holders of AMPS if the Fund is liquidated) of each share of AMPS will be \$25,000, plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared).

### Ratings

The AMPS will be issued with a rating of Aaa from Moody's Investors Service, Inc. ("Moody's") and AAA from Standard & Poor's ("S&P").

### Voting Rights

The 1940 Act requires that the holders of AMPS and any other preferred stock, including the Other AMPS, voting as a separate class, have the right to elect at least two directors at all times and to elect a majority of the directors at any time when dividends on the AMPS or any other preferred stock, including the Other AMPS, are unpaid for two full years. The Fund's Charter, the 1940 Act and the General Corporation Laws of the State of Maryland require holders of AMPS and any other preferred stock, including the Other AMPS, to vote as a separate class on certain other matters.

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### RISK FACTORS AND SPECIAL CONSIDERATIONS

An investment in the Fund's AMPS should not constitute a complete investment program.

Investment Considerations. Investors in AMPS should consider the following factors:

- o The credit ratings of the AMPS could be reduced or terminated while an investor holds the AMPS.

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- o Neither broker-dealers nor the Fund are obligated to purchase shares of AMPS in an auction or otherwise, nor is the Fund required to redeem shares of AMPS in the event of a failed auction.
- o If sufficient bids do not exist in an auction, the applicable dividend rate will be the maximum applicable dividend rate, and in such event, owners of AMPS wishing to sell will not be able to sell all, and may not be able to sell any, AMPS in the auction. As a result, investors may not have liquidity of investment.
- o Broker-dealers may submit orders in auctions for the AMPS for their own account. If a broker-dealer submits an order for its own account in any auction, it may have knowledge of orders placed through it in that auction and therefore have an advantage over other bidders, but such broker-dealer would not have knowledge of orders submitted by other broker-dealers in that auction.

Secondary Market. The broker-dealers intend to maintain a secondary trading market in the AMPS outside of auctions; however, they have no obligation to do so and there can be no assurance that a secondary market for the AMPS will develop or, if it does develop, that it will provide holders with a liquid trading market. The AMPS will not be registered on any stock exchange or on any automated quotation system. An increase in the level of interest rates likely will have an adverse effect on the secondary market price of the AMPS, and a selling stockholder may have to sell AMPS between auctions at a price per share of less than \$25,000.

Rating Agencies. The Fund will issue the AMPS only if the AMPS have received a rating of Aaa from Moody's and AAA from S&P. As a result of such ratings the Fund will be subject to guidelines of Moody's, S&P or another substitute NRSRO that may issue ratings for its preferred stock. These guidelines may impose asset coverage or portfolio composition requirements that are more stringent than those imposed by the 1940 Act and may prohibit or limit the use by the Fund of certain portfolio management techniques or investments. The Fund does not expect these guidelines to prevent the Investment Adviser from managing the Fund's portfolio in accordance with the Fund's investment objective and policies. Also, under certain circumstances, the Fund may voluntarily terminate compliance with Moody's or S&P's guidelines, or both, in which case the AMPS may no longer be rated by Moody's or S&P, as applicable, but will be rated by at least one rating agency.

New Jersey Municipal Bonds. The Fund is more exposed to risks affecting issuers of New Jersey Municipal Bonds than in a municipal bond fund that invests more widely. Economic forecasts as of October 2003 for the national and New Jersey economies project a modest economic recovery in the fourth quarter of 2003 and in 2004. New Jersey and the nation may experience further near-term slow growth and the expected recovery may stall into early 2004 if consumers, investors, and businesses become more cautious than currently assumed. The fundamentals of New Jersey's economic health, however, remain stable, and the long run prospects for economic growth in New Jersey in 2004 and beyond are favorable. Currently, the State of New Jersey's general obligation bonds are rated AA by S&P, Aa2 by Moody's and AA by Fitch Ratings. Additionally, on March 10, 2004, Moody's placed New Jersey's general obligation bonds on a rating watch for possible downgrade.

Interest Rate Risk and AMPS. The Fund issues shares of AMPS, which generally pay dividends based on short term interest rates. The Fund generally will purchase New Jersey Municipal Bonds and Municipal Bonds that pay interest at fixed or adjustable rates. If short term interest rates rise, dividend rates on the shares of AMPS may rise so that the amount of dividends paid to the holders of shares of AMPS exceeds the income from the Fund's portfolio securities. Because income from the Fund's entire investment portfolio (not

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just the portion of the portfolio purchased with the proceeds of the AMPS offering) is available to pay dividends on the shares of AMPS, dividend rates on the shares of AMPS would need to greatly exceed the Fund's net portfolio income before the Fund's ability

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to pay dividends on the shares of AMPS would be jeopardized. If market interest rates rise, this could negatively impact the value of the Fund's investment portfolio, reducing the amount of assets serving as asset coverage for the AMPS.

**Non-Diversification.** The Fund is registered as a "non-diversified" investment company. This means that the Fund may invest a greater percentage of its assets in a single issuer than a diversified investment company. Since the Fund may invest a relatively high percentage of its assets in a limited number of issuers, the Fund may be more exposed to any single economic, political or regulatory occurrence than a more widely-diversified fund. Even as a non-diversified fund, the Fund must still meet the diversification requirements applicable to regulated investment companies under the Federal income tax laws.

**Market Risk and Selection Risk.** Market risk is the risk that the bond market will go down in value, including the possibility that the market will go down sharply and unpredictably. Selection risk is the risk that the securities that Fund management selects will underperform the bond market, the relevant indices, or other funds with similar investment objectives and investment strategies.

**Tax Exempt Securities Market Risk.** The amount of public information available about New Jersey Municipal Bonds and Municipal Bonds in the Fund's portfolio is generally less than that for corporate equities or bonds, and the investment performance of the Fund may, therefore, be more dependent on the analytical abilities of the Investment Adviser than the performance of a stock fund or taxable bond fund.

**Interest Rate and Credit Risk.** The Fund invests in New Jersey Municipal Bonds and Municipal Bonds, which are subject to interest rate and credit risk. Interest rate risk is the risk that prices of New Jersey Municipal Bonds and Municipal Bonds generally increase when interest rates decline and decrease when interest rates increase. Prices of longer term securities generally change more in response to interest rate changes than prices of shorter term securities. The Fund's use of leverage by the issuance of preferred stock and its investment in inverse floating obligations, as discussed below, may increase interest rate risk. Because market interest rates are currently near their lowest levels in many years, there is a greater risk that the Fund's portfolio will decline in value if interest rates increase in the future. Credit risk is the risk that the issuer will be unable to pay the interest or principal when due. Changes in an issuer's credit rating or the market's perception of an issuer's creditworthiness may affect the value of the Fund's investment in that issuer. The degree of credit risk depends on both the financial condition of the issuer and the terms of the obligation.

**Call and Redemption Risk.** A New Jersey Municipal Bond's or Municipal Bond's issuer may call the bond for redemption before it matures. If this happens to a New Jersey Municipal Bond or Municipal Bond that the Fund holds, the Fund may lose income and may have to invest the proceeds in New Jersey Municipal Bonds or Municipal Bonds with lower yields.

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**Rating Categories.** The Fund intends to invest in New Jersey Municipal Bonds and Municipal Bonds that are rated investment grade by S&P, Moody's or Fitch Ratings, or in unrated New Jersey Municipal Bonds and Municipal Bonds that are considered by the Investment Adviser to possess similar credit characteristics. Obligations rated in the lowest investment grade category may have certain speculative characteristics. For example, their prices are more volatile, economic downturns and financial setbacks may affect their prices more negatively, and their trading market may be more limited.

**Reinvestment Risk.** Reinvestment risk is the risk that income from the Fund's portfolio will decline if and when the Fund invests the proceeds from matured, traded or called bonds at market interest rates that are below the portfolio's current earnings rate. A decline in income could negatively affect the Fund's yield, return or the market price of the common stock.

**Private Activity Bonds.** The Fund may invest in certain tax exempt securities classified as "private activity bonds." These bonds may subject certain investors in the Fund to the Federal alternative minimum tax.

**Liquidity of Investments.** Certain New Jersey Municipal Bonds and Municipal Bonds in which the Fund invests may lack an established secondary trading market or may be otherwise considered illiquid. Liquidity of a

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security relates to the ability to easily dispose of the security and the price to be obtained and does not generally relate to the credit risk or likelihood of receipt of cash at maturity. Illiquid securities may trade at a discount from comparable, more liquid investments.

**Portfolio Strategies.** The Fund may engage in various portfolio strategies both to seek to increase the return of the Fund and to seek to hedge its portfolio against adverse effects from movements in interest rates and in the securities markets. These portfolio strategies include the use of derivatives, such as indexed securities, inverse floating rate securities, options, futures, options on futures, interest rate swap transactions and credit default swaps. Such strategies subject the Fund to the risk that, if the Investment Adviser incorrectly forecasts market values, interest rates or other applicable factors, the Fund's performance could suffer. Certain of these strategies, such as investments in inverse floating rate securities and credit default swaps, may provide investment leverage to the Fund's portfolio. The Fund is not required to use derivatives or other portfolio strategies to seek to increase return or to seek to hedge its portfolio and may choose not to do so. There can be no assurance that the Fund's portfolio strategies will be effective. Some of the derivative strategies that the Fund may use to seek to increase its return are riskier than its hedging transactions and have speculative characteristics. Such strategies do not attempt to limit the Fund's risk of loss.

**General Risks Related to Derivatives.** Derivatives are financial contracts or instruments whose value depends on, or is derived from, the value of an underlying asset, reference rate or index (or relationship between two indices). The Fund may invest in a variety of derivative instruments for investment purposes, hedging purposes or to seek to increase its return, such as options, futures contracts and swap agreements. The Fund may use derivatives as a substitute for taking a position in an underlying security or

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other asset and/or as part of a strategy designed to reduce exposure to other risks, such as interest rate risk. The Fund also may use derivatives to add leverage to the portfolio and/or to hedge against increases in the Fund's costs associated with the dividend payments on the preferred stock, including the AMPS. The Fund also may invest in certain derivative products that pay tax exempt income interest via a trust or partnership through which the Fund holds interests in one or more underlying long term municipal securities. The Fund's use of derivative instruments involves risks different from, and possibly greater than, the risks associated with investing directly in securities and other traditional investments. Derivatives are subject to a number of risks such as liquidity risk, interest rate risk, credit risk, leverage risk, the risk of ambiguous documentation and management risk. They also involve the risk of mispricing or improper valuation and correlation risk (i.e., the risk that changes in the value of the derivative may not correlate perfectly with the underlying asset, rate or index). If the Fund invests in a derivative instrument it could lose more than the principal amount invested. Moreover, derivatives raise certain tax, legal, regulatory and accounting issues that may not be presented by investments in New Jersey Municipal Bonds and Municipal Bonds, and there is some risk that certain issues could be resolved in a manner that could adversely impact the performance of the Fund and/or the tax exempt nature of the dividends paid by the Fund.

Also, suitable derivative transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in these transactions to reduce exposure to other risks when that would be beneficial.

Swaps. Swap agreements are types of derivatives. In order to seek to hedge the value of the Fund's portfolio, to hedge against increases in the Fund's cost associated with the interest payments on its outstanding borrowings or to seek to increase the Fund's return, the Fund may enter into interest rate, credit default or total return swap transactions. In interest rate swap transactions, there is a risk that yields will move in the direction opposite of the direction anticipated by the Fund, which would cause the Fund to make payments to its counterparty in the transaction that could adversely affect Fund performance. In addition to the risks applicable to swaps generally, credit default swap transactions involve special risks because they are difficult to value, are highly susceptible to liquidity and credit risk, and generally pay a return to the party that has paid the premium only in the event of an actual default by the issuer of the underlying obligation (as opposed to a credit downgrade or other indication of financial difficulty). Total return swap transactions involve the risks that the counterparty will default on its payment obligation to the Fund in the transaction and that the Fund will not be able to meet its obligation to the counterparty in the transaction. The Fund is not required to enter into interest rate, credit default or total return swap transactions for hedging purposes or to enhance its return and may choose not to do so.

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Taxability Risk. The Fund intends to minimize the payment of taxable income to stockholders by investing in New Jersey Municipal Bonds, Municipal Bonds and other tax exempt securities in reliance on an opinion of bond counsel to the issuer that the interest paid on those securities will be excludable from gross income for Federal income tax purposes and exempt from New Jersey personal income tax. Such securities, however, may be determined for Federal income tax purposes to pay, or to have paid, taxable income subsequent to the Fund's acquisition of the securities. In that event, the

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Internal Revenue Service may demand that the Fund pay taxes on the affected interest income, and, if the Fund agrees to do so, the Fund's yield on its common stock could be adversely affected. A determination that interest on a security held by the Fund is includable in gross income for Federal income tax purposes retroactively to its date of issue may, likewise, cause a portion of prior distributions received by stockholders, including holders of AMPS, to be taxable to those stockholders in the year of receipt. The Fund will not pay an Additional Dividend (as defined herein) to a holder of AMPS under these circumstances. If a security acquired based on reliance on such an opinion of counsel is subsequently determined to pay interest that is includable in gross income for Federal income tax purposes, the Fund will dispose of that security as soon as reasonably practicable.

**Antitakeover Provisions.** The Fund's Charter, By-laws and the General Corporation Law of the State of Maryland include provisions that could limit the ability of other entities or persons to acquire control of the Fund or to change the composition of its Board of Directors. Such provisions could limit the ability of stockholders to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund.

**Market Disruption.** The terrorist attacks in the United States on September 11, 2001 had a disruptive effect on the securities markets, some of which were closed for a four-day period. The continued threat of similar attacks, and related events, including U.S. military actions in Iraq and continued unrest in the Middle East, have led to increased short term market volatility and may have long term effects on U.S. and world economies and markets. Similar disruptions of the financial markets could adversely affect the market prices of the Fund's portfolio securities, interest rates, auctions, secondary trading, ratings, credit risk, inflation and other factors relating to the Fund's AMPS.

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### FINANCIAL HIGHLIGHTS

The following Financial Highlights table is intended to help you understand the Fund's financial performance for the periods shown. Certain information reflects financial results for a single share of common stock or preferred stock of the Fund. The total returns in the table represent the rate an investor would have earned or lost on an investment in shares of common stock of the Fund (assuming reinvestment of all dividends). The information with respect to the fiscal years ended November 30, 1994 to November 30, 2003 has been audited by \_\_\_\_\_ whose report for the fiscal year ended November 30, 2003, along with the financial statements of the Fund, is included in the Fund's 2003 Annual Report, which is incorporated by reference herein. The information with respect to the six months ended May 31, 2004 is unaudited and is included in the Fund's 2004 Semi-Annual Report, which is incorporated by reference herein. You may obtain a copy of the 2003 Annual Report and the 2004 Semi-Annual Report at no cost by calling (800) 543-6217 between 8:30 a.m. and 5:30 p.m. Eastern time on any business day.

The following per share data and ratios have been derived from information provided in the financial statements.

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	For the Six Months Ended May 31,	For the Year Ended		
	2004 (unaudited)	2003	2002	2001
Increase (Decrease) in Net Asset Value:				
Per Share Operating Performance				
Net asset value, beginning of period	\$	\$ 14.84	\$ 14.78	
Investment income-- net	++	1.05++	1.06	
Realized and unrealized gain (loss) on investments-- net		.52	.05	
Dividends and distributions to Preferred Stock shareholders:				
Investment income-- net		(.06)	(.09)	
Realized gain on investments-- net	--	--	--+	
In excess of realized gain on investments-- net	--	--	--	
Total from investment operations		1.51	1.02	
Less dividends and distributions to Common Stock shareholders:				
Investment income-- net	( )	(.96)	(.96)	
Realized gain on investments-- net	--	--	--+	
In excess of realized gain on investments-- net	--	--	--	
Total dividends and distributions to Common Stock shareholders:	( )	(.96)	(.96)	
Effect of Preferred Stock activity:++++				
Dividends and distributions to Preferred Stock shareholders:				
Investment income-- net	--	--	--	
Realized gain on investments-- net	--	--	--	
Total effect of Preferred Stock activity	--	--	--	
Net asset value, end of period	\$	\$15.39	\$14.84	
Market price per share, end of period	\$	\$14.34	\$14.07	
Total Investment Return*				
Based on market price per share	( ) %##	8.90%	4.27%	
Based on net asset value per share	%##	10.81%	7.22%	
Ratios Based on Average Net Assets of Common Stock				
Total expenses, net of reimbursement and excluding reorganization				



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expenses**	%#	1.02%	1.05%
Total expenses, excluding reorganization expenses**		1.02%	1.05%
Total expenses**	%#	1.02%	1.05%
Total investment income-- net**	%#	6.94%	7.06%
Amount of dividends to Preferred Stock shareholders	%#	.40%	.58%

[TABLE CONTINUED]

	For the Year Ended November 30,		
	1999++	1998	1997
Increase (Decrease) in Net Asset Value: Per Share Operating Performance			
Net asset value, beginning of period	\$ 15.93	\$ 15.51	\$ 15.46
Investment income-- net	1.06	1.13	1.14
Realized and unrealized gain (loss) on investments-- net	(1.98)	.42	.05
Dividends and distributions to Preferred Stock shareholders:			
Investment income-- net	(.19)	--	--
Realized gain on investments-- net	--	--	--
In excess of realized gain on investments-- net	(.04)	--	--
Total from investment operations	(1.15)	1.55	1.19
Less dividends and distributions to Common Stock shareholders:			
Investment income-- net	(.87)	(.89)	(.91)
Realized gain on investments-- net	--	--	--
In excess of realized gain on investments-- net	(.31)	--	--
Total dividends and distributions to Common Stock shareholders:	(1.18)	(.89)	(.91)
Effect of Preferred Stock activity:++++			
Dividends and distributions to Preferred Stock shareholders:			
Investment income-- net	--	(.21)	(.23)
Realized gain on investments-- net	--	(.03)	--
Total effect of Preferred Stock activity	--	(.24)	(.23)

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Net asset value, end of period	\$13.60	\$15.93	\$15.51
Market price per share, end of period	\$12.25	\$16.75	\$15.5625
Total Investment Return*			
Based on market price per share	(20.75%)	13.89%	13.96%
Based on net asset value per share	(7.48%)	8.68%	6.52%
Ratios Based on Average Net Assets of Common Stock			
Total expenses, net of reimbursement and excluding reorganization expenses**	1.05%	--	--
Total expenses, excluding reorganization expenses**	1.05%		
Total expenses**	1.05%	--	--
Total investment income-- net**	7.16%	--	--
Amount of dividends to Preferred Stock shareholders	1.25%	--	--

[TABLE CONTINUED]

	For the Year Ended November 30,	
	1995	1994
Increase (Decrease) in Net Asset Value:		
Per Share Operating Performance		
Net asset value, beginning of period	\$ 13.22	\$ 15.88
Investment income-- net	1.17	1.15
Realized and unrealized gain (loss) on investments-- net	2.33	(2.67)
Dividends and distributions to Preferred Stock shareholders:		
Investment income-- net	--	--
Realized gain on investments-- net	--	--
In excess of realized gain on investments-- net	--	--
Total from investment operations	3.50	(1.52)
Less dividends and distributions to Common Stock shareholders:		
Investment income-- net	(.90)	(.93)
Realized gain on investments-- net	--	(.01)
In excess of realized gain on investments-- net	--	--

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Total dividends and distributions to Common Stock shareholders:	(.90)	(.94)
Effect of Preferred Stock activity:++++		
Dividends and distributions to Preferred Stock shareholders:		
Investment income-- net	(.26)	(.20)
Realized gain on investments-- net	--	--
Total effect of Preferred Stock activity	(.26)	(.20)
Net asset value, end of period	\$15.56	\$13.22
Market price per share, end of period	\$13.75	\$12.125
Total Investment Return*		
Based on market price per share	21.26%	(16.87%)
Based on net asset value per share	25.85%	(10.82%)
Ratios Based on Average Net Assets of Common Stock		
Total expenses, net of reimbursement and excluding reorganization expenses**	--	--
Total expenses, excluding reorganization expenses**		
Total expenses**	--	--
Total investment income-- net**	--	--
Amount of dividends to Preferred Stock shareholders	--	--

(continued on following page)

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(continued from prior page)

For the Six Months Ended May 31,	For the Year Ended No		
2004 (unaudited)	2003	2002	20

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Investment income-- net, to Common Stock shareholders	%#	6.54%	6.48%
=====	=====	=====	=====
Ratios Based on Average Net Assets of Common & Preferred Stock**++++			
Total expenses, net of reimbursement and excluding reorganization expenses	%#	.70%	.72%
=====	=====	=====	=====
Total expenses, excluding reorganization expenses		.70%	.72%
=====	=====	=====	=====
Total expenses	%#	.70%	.72%
=====	=====	=====	=====
Total investment income-- net	%#	4.78%	4.83%
=====	=====	=====	=====
Ratios Based on Average Net Assets of Preferred Stock + + + +			
Dividends to Preferred Stock shareholders	%#	.89%	1.25%
=====	=====	=====	=====
Supplemental Data			
Net assets applicable to Common Stock, end of period (in thousands)	\$	\$218,642	\$210,727
=====	=====	=====	=====
Preferred Stock outstanding, end of period (in thousands)	\$	\$97,500	\$97,500
=====	=====	=====	=====
Portfolio turnover	%	28.93%	41.47%
=====	=====	=====	=====
Leverage:			
Asset coverage per \$1,000	\$	\$3,242	\$3,161
=====	=====	=====	=====
Dividends Per Share on Preferred Stock Outstanding+++			
Series A - Investment income-- net	\$	\$225	\$325
=====	=====	=====	=====
Series B - Investment income-- net	\$	\$219	\$292
=====	=====	=====	=====

[TABLE CONTINUED]

(continued from prior page)

	For the Year Ended November 30,		
	-----	-----	-----
	1999++	1998	1997
	-----	-----	-----
Investment income-- net, to Common Stock shareholders	5.91%	--	--
=====	=====	=====	=====
Ratios Based on Average Net Assets ++++			
of Common & Preferred Stock**			
Total expenses, net of reimbursement and excluding reorganization expenses	.73%	--	--
=====	=====	=====	=====

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Total expenses, excluding reorganization expenses	.73%		
Total expenses	.73%	.71%	.72%
Total investment income-- net	4.95%	5.03%	5.14%
Ratios Based on Average Net Assets of Preferred Stock + + + + Dividends to Preferred Stock shareholders			
	2.81%	--	--
Supplemental Data			
Net assets applicable to Common Stock, end of period (in thousands)	\$123,760	\$143,259	\$137,633
Preferred Stock outstanding, end of period (in thousands)	\$60,000	\$60,000	\$60,000
Portfolio turnover	57.94%	46.83%	30.50%
Leverage:			
Asset coverage per \$1,000	\$3,063	\$3,388	\$3,294
Dividends Per Share on Preferred Stock Outstanding+++			
Series A - Investment income-- net	\$703	\$798	\$838
Series B - Investment income-- net	--	--	--

[TABLE CONTINUED]

(continued from prior page)

For the Year Ended November 30,			
	1995	1994	
Investment income-- net, to Common Stock shareholders	--	--	
Ratios Based on Average Net Assets of Common & Preferred Stock**++++			
Total expenses, net of reimbursement and excluding reorganization expenses	--	--	
Total expenses, excluding reorganization expenses			
Total expenses	.73%	.74%	
Total investment income-- net	5.40%	5.30%	
Ratios Based on Average Net Assets of Preferred Stock + + + +			

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Dividends to Preferred Stock shareholders	--	--
	=====	=====
Supplemental Data		
Net assets applicable to Common		
Stock, end of period (in thousands)	\$137,355	\$116,746
	=====	=====
Preferred Stock outstanding, end of period (in thousands)	\$60,000	\$60,000
	=====	=====
Portfolio turnover	32.79%	15.06%
	=====	=====
Leverage:		
Asset coverage per \$1,000	\$3,289	\$2,946
	=====	=====
Dividends Per Share on Preferred Stock Outstanding+++		
Series A - Investment income-- net	\$938	\$741
	=====	=====
Series B - Investment income-- net	--	--
	=====	=====

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- \* Total investment returns based on market value, which can be significantly greater or lesser than the net asset value, may result in substantially different returns. Total investment returns exclude the effects of sales charges.
  - \*\* Do not reflect the effect of dividends to Preferred Stock shareholders.
  - + Amount is less than \$(.01) per share.
  - ++ Certain prior year amounts have been reclassified to conform to current year presentation.
  - +++ Dividends have been adjusted to reflect a two-for-one stock split that occurred on December 1, 1994.
  - ++++ The Fund's Preferred Stock was issued on November 30, 1992 (Series A) and February 7, 2000 (Series B).
  - ++ Based on average shares outstanding.
  - # Annualized.
  - ## Aggregate total investment return.

### THE FUND

MuniYield New Jersey Fund, Inc. (the "Fund") is a non-diversified, closed-end fund. The Fund was incorporated under the laws of the State of Maryland on February 21, 1992, and has registered under the Investment Company Act of 1940, as amended. The Fund's principal office is located at 800 Scudders Mill Road, Plainsboro, New Jersey 08536, and its telephone number is (609) 282-2800.

The Board of Directors of the Fund may at any time consider a merger, consolidation or other form of reorganization of the Fund with one or more other investment companies advised by the Investment Adviser that have similar investment objectives and policies as the Fund. Any such merger, consolidation or other form of reorganization would require the prior approval of the Board of Directors and, if the Fund is the acquired fund, the stockholders of the Fund. See "Description of Capital Stock--Certain Provisions of the Charter and By-laws."

### USE OF PROCEEDS

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The net proceeds of this offering will be approximately \$27,090,000 after payment of offering expenses (estimated to be approximately \$135,000) and the deduction of the underwriting discount.

The net proceeds of the offering will be invested in accordance with the Fund's investment objective and policies within approximately three months after completion of this offering, depending on market conditions and the availability of appropriate securities. Pending such investment, it is anticipated that the proceeds will be invested in short term, tax exempt securities. See "Investment Objective and Policies."

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### CAPITALIZATION

The following table sets forth the unaudited capitalization of the Fund as of May 31, 2004 and as adjusted to give effect to the issuance of the shares of AMPS offered hereby.

	Actual
Preferred stock (3,900 shares of Other AMPS authorized, issued and outstanding at \$25,000 per share liquidation preference, plus accumulated but unpaid dividends; 5,000 shares of AMPS and Other AMPS authorized, issued and outstanding, as adjusted, at \$25,000 per share liquidation preference, plus accumulated but unpaid dividends) .....	\$
Common Stock, par value \$.10 per share (199,996,100 shares authorized, _____ shares issued and outstanding; 199,995,000 shares authorized, _____ shares issued and outstanding, as adjusted)	
Paid-in capital in excess of par value.....	
Undistributed investment income--net.....	
Accumulated realized capital losses on investments--net.....	( )
Unrealized appreciation on investments--net.....	
Net assets applicable to outstanding common stock.....	\$

### PORTFOLIO COMPOSITION

As of May 31, 2004, approximately % of the market value of the Fund's portfolio was invested in long term municipal obligations and approximately % of the market value of the Fund's portfolio was invested in short term tax exempt securities. The following table sets forth certain information with respect to the composition of the Fund's long term municipal obligation investment portfolio as of May 31, 2004.

Moody's*	Fitch*	S&P*	Number of Issues	Value (in thousands)	Percent
----------	--------	------	---------------------	-------------------------	---------

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Aaa	AAA	AAA	\$	%
Aa	AA	AA		%
A	A	A		%
Baa	BBB	BBB		%
Total.....			\$	100%
			=====	=====

\* Ratings: Using the higher of Moody's, S&P or Fitch Ratings ("Fitch") ratings on the Fund's investments. See "Schedule of Investments." Moody's rating categories may be modified further by a 1, 2 or 3 in Aa, A, Baa, Ba, B and Caa ratings. S&P rating categories may be modified further by a plus (+) or minus (-) in AA, A, BBB, BB, B and CCC ratings. Fitch rating categories may be modified further by a plus (+) or minus (-) in AA, A, BBB, BB, B and CCC.

## INVESTMENT OBJECTIVE AND POLICIES

The Fund's investment objective is to provide shareholders with as high a level of current income exempt from Federal income taxes and New Jersey personal income tax as is consistent with its investment policies and prudent investment management. The Fund seeks to achieve its investment objective by investing at least 80% of an aggregate of the Fund's net assets (including proceeds from the issuance of any preferred stock) and the proceeds of any borrowings for investment purposes, in a portfolio of municipal obligations issued by or on behalf of the State of New Jersey, its political subdivisions, agencies and instrumentalities and by other qualifying issuers, each of which pays interest that, in the opinion of bond counsel to the issuer, is excludable from gross income for Federal income tax purposes (except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax) and exempt from New Jersey personal income tax ("New Jersey Municipal Bonds"). The Fund also may invest in municipal obligations issued by or on behalf of states, territories and possessions of the

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United States and their political subdivisions, agencies or instrumentalities, each of which pays interest that, in the opinion of bond counsel to the issuer, is excludable from gross income for Federal income tax purposes but is not exempt from gross income for New Jersey personal income tax purposes ("Municipal Bonds"). Unless otherwise noted, the term "Municipal Bonds" also includes New Jersey Municipal Bonds. The Fund typically invests at least 80% of its total assets in New Jersey Municipal Bonds. The Fund's investment objective and its policy of investing at least 80% of an aggregate of the Fund's net assets (including proceeds from the issuance of any preferred stock) and the proceeds of any borrowings for investment purposes, in New Jersey Municipal Bonds are fundamental policies that may not be changed without the approval of a majority of the outstanding voting securities of the Fund (as defined in the 1940 Act). There can be no assurance that the Fund's investment objective will be realized.

The Fund may invest in certain tax exempt securities classified as "private activity bonds" (or industrial development bonds, under pre-1986 law) ("PABs") (in general, bonds that benefit non-governmental entities) that may subject certain investors in the Fund to an alternative minimum tax. See "Taxes." The percentage of the Fund's total assets invested in PABs will vary from time to time. The Fund also will not invest more than 25% of its total



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assets (taken at market value at the time of each investment) in Municipal Bonds whose issuers are located in the same state.

Under normal market conditions, the Fund expects to invest primarily in a portfolio of long term Municipal Bonds that are commonly referred to as "investment grade" securities, which are obligations rated at the time of purchase within the four highest quality ratings as determined by either Moody's Investors Service, Inc. ("Moody's") (currently Aaa, Aa, A and Baa), Standard & Poor's ("S&P") (currently AAA, AA, A and BBB) or Fitch Ratings ("Fitch") (currently AAA, AA, A and BBB). In the case of short term notes, the investment grade rating categories are SP-1+ through SP-2 for S&P, MIG-1 through MIG-3 for Moody's and F-1+ through F-3 for Fitch. In the case of tax exempt commercial paper, the investment grade rating categories are A-1+ through A-3 for S&P, Prime-1 through Prime-3 for Moody's and F-1+ through F-3 for Fitch. Obligations ranked in the lowest investment grade rating category (BBB, SP-2 and A-3 for SP Baa, MIG-3 and Prime-3 for Moody's and BBB and F-3 for Fitch), while considered "investment grade," may have certain speculative characteristics. There may be sub-categories or gradations indicating relative standing within the rating categories set forth above. In assessing the quality of Municipal Bonds with respect to the foregoing requirements, the Investment Adviser takes into account the nature of any letters of credit or similar credit enhancement to which particular Municipal Bonds are entitled and the creditworthiness of the financial institution which provided such credit enhancement. See Appendix B--"Description of Municipal Bond Ratings" to the statement of additional information. If unrated, such securities will possess creditworthiness comparable, in the opinion of the Investment Adviser, to other obligations in which the Fund may invest.

All percentage and ratings limitations on securities in which the Fund may invest apply at the time of making an investment and shall not be considered violated if an investment rating is subsequently downgraded to a rating that would have precluded the Fund's initial investment in such security. In the event that the Fund disposes of a portfolio security subsequent to its being downgraded, the Fund may experience a greater risk of loss than if such security had been sold prior to such downgrade.

The average maturity of the Fund's portfolio securities will vary based upon the Investment Adviser's assessment of economic and market conditions. The net asset value of the shares of common stock of a closed-end investment company, such as the Fund, which invests primarily in fixed income securities, changes as the general levels of interest rates fluctuate. When interest rates decline, the value of a fixed income portfolio can be expected to rise. Conversely, when interest rates rise, the value of a fixed income portfolio can be expected to decline. Prices of longer term securities generally fluctuate more in response to interest rate changes than do shorter term securities. These changes in net asset value are likely to be greater in the case of a fund having a leveraged capital structure, such as the Fund.

For temporary periods or to provide liquidity, the Fund has the authority to invest as much as 20% of its total assets in tax exempt and taxable money market obligations with a maturity of one year or less (such short term obligations being referred to herein as "Temporary Investments"). In addition, the Fund reserves the right as a defensive measure to invest temporarily a greater portion of its assets in Temporary Investments, when, in the opinion of the Investment Adviser, prevailing market or financial conditions warrant. Taxable money market obligations will yield taxable income. The Fund also may invest in variable rate demand obligations ("VRDOs")

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and VRDOs in the form of participation interests ("Participating VRDOs") in variable rate tax exempt obligations held by a financial institution. See "Other Investment Policies -- Temporary Investments." The Fund's hedging strategies, which are described in more detail under "Hedging Transactions -- Financial Futures Transactions and Options," are not fundamental policies and may be modified by the Board of Directors of the Fund without the approval of the Fund's stockholders. The Fund is also authorized to invest in indexed and inverse floating rate obligations for hedging purposes and to seek to enhance return.

The Fund may invest in securities not issued by or on behalf of a state or territory or by an agency or instrumentality thereof, if the Fund receives an opinion of counsel to the issuer that such securities pay interest that is excludable from gross income for Federal income tax purposes and, if applicable, exempt from New Jersey personal income tax ("Non-Municipal Tax Exempt Securities"). Non-Municipal Tax Exempt Securities could include trust certificates, partnership interests or other instruments evidencing interest in one or more long term municipal securities. Non-Municipal Tax Exempt Securities also may include securities issued by other investment companies that invest in Municipal Bonds, to the extent such investments are permitted by the Fund's investment restrictions and applicable law. Non-Municipal Tax Exempt Securities are subject to the same risks associated with an investment in Municipal Bonds as well as many of the risks associated with investments in derivatives. While the Fund receives opinions of legal counsel to the effect that the income from the Non-Municipal Tax Exempt Securities in which the Fund invests is excludable from gross income for Federal income tax purposes to the same extent as the underlying municipal securities, the Internal Revenue Service ("IRS") has not issued a ruling on this subject. Were the IRS to issue an adverse ruling or take an adverse position with respect to the taxation of these types of securities, there is a risk that the interest paid on such securities would be deemed taxable at the Federal level.

The Fund ordinarily does not intend to realize significant investment income not exempt from Federal income tax and New Jersey personal income tax. From time to time, the Fund may realize taxable capital gains.

Federal tax legislation has limited the types and volume of bonds the interest on which qualifies for a Federal income tax exemption. As a result, this legislation and legislation that may be enacted in the future may affect the availability of Municipal Bonds for investment by the Fund.

### Risk Factors and Special Considerations Relating to New Jersey Municipal Bonds

The Fund ordinarily will invest at least 80% of its total assets in New Jersey Municipal Bonds; therefore, it is more susceptible to factors adversely affecting issuers of New Jersey Municipal Bonds than is a municipal bond fund that is not concentrated in issuers of New Jersey Municipal Bonds to this degree. The Investment Adviser does not believe that the current economic conditions in New Jersey will have a significant adverse effect on the Fund's ability to invest in high quality New Jersey Municipal Bonds. Currently, New Jersey general obligation bonds are rated AA by S&P, Aa2 by Moody's and AA by Fitch. Additionally, on March 10, 2004, Moody's placed New Jersey's general obligation bonds on a rating watch for possible downgrade. No assurance can be given that such rating will not be lowered in the future. For a discussion of economic and other conditions in the State of New Jersey, see Appendix A-- "Economic and Other Conditions in New Jersey" in the statement of additional information.

### Risk Factors and Special Considerations Relating to Municipal Bonds

The risks and special considerations involved in investment in Municipal

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Bonds vary with the types of instruments being acquired. Investments in Non-Municipal Tax Exempt Securities may present similar risks, depending on the particular product. Certain instruments in which the Fund may invest may be characterized as derivative instruments. See "-- Description of Municipal Bonds" and "-- Hedging Transactions -- Financial Futures Transactions and Options."

The value of Municipal Bonds generally may be affected by uncertainties in the municipal markets as a result of legislation or litigation, including legislation or litigation that changes the taxation of Municipal Bonds or the rights of Municipal Bond holders in the event of a bankruptcy. Municipal bankruptcies are rare, and certain provisions of the U.S. Bankruptcy Code governing such bankruptcies are unclear. Further, the application of state law to Municipal Bond issuers could produce varying results among the states or among Municipal Bond issuers

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within a state. These uncertainties could have a significant impact on the prices of the Municipal Bonds in which the Fund invests.

### Description of Municipal Bonds

Set forth below is a detailed description of the Municipal Bonds and Temporary Investments in which the Fund may invest. Information with respect to ratings assigned to tax exempt obligations that the Fund may purchase is set forth in Appendix B to the statement of additional information. Obligations are included within the term Municipal Bonds if the interest paid thereon is excluded from gross income for Federal income tax purposes in the opinion of bond counsel to the issuer.

Municipal Bonds include debt obligations issued to obtain funds for various public purposes, including the construction of a wide range of public facilities, refunding of outstanding obligations and obtaining funds for general operating expenses and loans to other public institutions and facilities. In addition, certain types of bonds are issued by or on behalf of public authorities to finance various privately owned or operated facilities, including certain facilities for the local furnishing of electric energy or gas, sewage facilities, solid waste disposal facilities and other specialized facilities. Other types of PABs, the proceeds of which are used for the construction, equipment or improvement of privately operated industrial or commercial facilities, may constitute Municipal Bonds, although the current Federal tax laws place substantial limitations on the size of such issues. The interest on Municipal Bonds may bear a fixed rate or be payable at a variable or floating rate. The two principal classifications of Municipal Bonds are "general obligation" and "revenue" bonds, which latter category includes PABs.

The Fund has not established any limit on the percentage of its portfolio that may be invested in PABs. The Fund may not be a suitable investment for investors who are already subject to the Federal alternative minimum tax or who would become subject to the Federal alternative minimum tax as a result of an investment in the Fund's common stock. See "Taxes."

General Obligation Bonds. General obligation bonds are secured by the issuer's pledge of its faith, credit and taxing power for the payment of principal and interest. The taxing power of any governmental entity may be limited, however, by provisions of its state constitution or laws, and an entity's creditworthiness will depend on many factors, including potential erosion of its tax base due to population declines, natural disasters,

declines in the state's industrial base or inability to attract new industries, economic limits on the ability to tax without eroding the tax base, state legislative proposals or voter initiatives to limit ad valorem real property taxes and the extent to which the entity relies on Federal or state aid, access to capital markets or other factors beyond the state's or entity's control. Accordingly, the capacity of the issuer of a general obligation bond as to the timely payment of interest and the repayment of principal when due is affected by the issuer's maintenance of its tax base.

Revenue Bonds. Revenue bonds are payable only from the revenues derived from a particular facility or class of facilities or, in some cases, from the proceeds of a special excise tax or other specific revenue sources such as payments from the user of the facility being financed. Accordingly, the timely payment of interest and the repayment of principal in accordance with the terms of the revenue or special obligation bond is a function of the economic viability of such facility or such revenue source.

PABs. The Fund may purchase PABs. PABs are, in most cases, tax exempt securities issued by states, municipalities or public authorities to provide funds, usually through a loan or lease arrangement, to a private entity for the purpose of financing construction or improvement of a facility to be used by the entity. Such bonds are secured primarily by revenues derived from loan repayments or lease payments due from the entity which may or may not be guaranteed by a parent company or otherwise secured. PABs generally are not secured by a pledge of the taxing power of the issuer of such bonds. Therefore, an investor should be aware that repayment of such bonds generally depends on the revenues of a private entity and be aware of the risks that such an investment may entail. Continued ability of an entity to generate sufficient revenues for the payment of principal and interest on such bonds will be affected by many factors including the size of the entity, capital structure, demand for its products or services, competition, general economic conditions, government regulation and the entity's dependence on revenues for the operation of the particular facility being financed.

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Moral Obligation Bonds. The Fund also may invest in "moral obligation" bonds, which are normally issued by special purpose public authorities. If an issuer of moral obligation bonds is unable to meet its obligations, the repayment of such bonds becomes a moral commitment but not a legal obligation of the state or municipality in question.

Municipal Lease Obligations. Also included within the general category of Municipal Bonds are certificates of participation ("COPs") issued by government authorities or entities to finance the acquisition or construction of equipment, land and/or facilities. COPs represent participations in a lease, an installment purchase contract or a conditional sales contract (hereinafter collectively called "lease obligations") relating to such equipment, land or facilities. Although lease obligations do not constitute general obligations of the issuer for which the issuer's unlimited taxing power is pledged, a lease obligation is frequently backed by the issuer's covenant to budget for, appropriate and make the payments due under the lease obligation. However, certain lease obligations contain "non-appropriation" clauses which provide that the issuer has no obligation to make lease or installment purchase payments in future years unless money is appropriated for such purpose on a yearly basis. Although "non-appropriation" lease obligations are secured by the leased property, disposition of the property in the event of foreclosure might prove difficult and the value of the property may be insufficient to issue lease obligations. Certain investments in lease

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obligations may be illiquid.

Indexed and Inverse Floating Rate Securities. The Fund may invest in Municipal Bonds (and Non- Municipal Tax Exempt Securities) that yield a return based on a particular index of value or interest rates. For example, the Fund may invest in Municipal Bonds that pay interest based on an index of Municipal Bond interest rates. The principal amount payable upon maturity of certain Municipal Bonds also may be based on the value of the index. To the extent the Fund invests in these types of Municipal Bonds, the Fund's return on such Municipal Bonds will be subject to risk with respect to the value of the particular index. Interest and principal payable on the Municipal Bonds may also be based on relative changes among particular indices. Also, the Fund may invest in so-called "inverse floating obligations" or "residual interest bonds" on which the interest rates vary inversely with a short term floating rate (which may be reset periodically by a dutch auction, a remarketing agent, or by reference to a short term tax exempt interest rate index). The Fund may purchase synthetically created inverse floating rate bonds evidenced by custodial or trust receipts. Generally, income on inverse floating rate bonds will decrease when short term interest rates increase, and will increase when short term interest rates decrease. Such securities have the effect of providing a degree of investment leverage, since they may increase or decrease in value in response to changes, as an illustration, in market interest rates at a rate which is a multiple (typically two) of the rate at which fixed rate long term tax exempt securities increase or decrease in response to such changes. As a result, the market values of such securities will generally be more volatile than the market values of fixed rate tax exempt securities. To seek to limit the volatility of these securities, the Fund may purchase inverse floating obligations with shorter-term maturities or which contain limitations on the extent to which the interest rate may vary. Certain investments in such obligations may be illiquid.

When Issued Securities, Delayed Delivery Securities and Forward Commitments. The Fund may purchase or sell securities that it is entitled to receive on a when issued basis. The Fund may also purchase or sell securities on a delayed delivery basis. The Fund may also purchase or sell securities through a forward commitment. These transactions involve the purchase or sale of securities by the Fund at an established price with payment and delivery taking place in the future. The purchase will be recorded on the date the Fund enters into the commitment and the value of the securities will thereafter be reflected in the Fund's net asset value. The Fund enters into these transactions to obtain what is considered an advantageous price to the Fund at the time of entering into the transaction. The Fund has not established any limit on the percentage of its assets that may be committed in connection with these transactions. When the Fund purchases securities in these transactions, the Fund segregates liquid securities in an amount equal to the amount of its purchase commitments.

There can be no assurance that a security purchased on a when issued basis will be issued or that a security purchased or sold through a forward commitment will be delivered. A default by a counterparty may result in the Fund missing the opportunity of obtaining a price considered to be advantageous. The value of securities in these transactions on the delivery date may be more or less than the Fund's purchase price. The Fund may bear the risk of a decline in the value of the security in these transactions and may not benefit from an appreciation in the value of the security during the commitment period.

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**Call Rights.** The Fund may purchase a Municipal Bond issuer's right to call all or a portion of such Municipal Bond for mandatory tender for purchase (a "Call Right"). A holder of a Call Right may exercise such right to require a mandatory tender for the purchase of related Municipal Bonds, subject to certain conditions. A Call Right that is not exercised prior to maturity of the related Municipal Bond will expire without value. The economic effect of holding both the Call Right and the related Municipal Bond is identical to holding a Municipal Bond as a non-callable security. Certain investments in such obligations may be illiquid.

**Yields.** Yields on Municipal Bonds are dependent on a variety of factors, including the general condition of the money market and of the municipal bond market, the size of a particular offering, the financial condition of the issuer, the maturity of the obligation and the rating of the issue. The ability of the Fund to achieve its investment objective is also dependent on the continuing ability of the issuers of the securities in which the Fund invests to meet their obligations for the payment of interest and principal when due. There are variations in the risks involved in holding Municipal Bonds, both within a particular classification and between classifications, depending on numerous factors. Furthermore, the rights of owners of Municipal Bonds and the obligations of the issuer of such Municipal Bonds may be subject to applicable bankruptcy, insolvency and similar laws and court decisions affecting the rights of creditors generally and to general equitable principles, which may limit the enforcement of certain remedies.

### Hedging Transactions

The Fund may hedge all or a portion of its portfolio investments against fluctuations in interest rates through the use of options and certain financial futures contracts and options thereon. While the Fund's use of hedging strategies is intended to reduce the volatility of the net asset value of the Fund's shares of common stock, the net asset value of the Fund's shares of common stock will fluctuate. No assurance can be given that the Fund's hedging transactions will be effective. The Fund only may engage in hedging activities from time to time and may not necessarily be engaging in hedging activities when movements in interest rates occur. The Fund has no obligation to enter into hedging transactions and may choose not to do so. Furthermore, for so long as the AMPS are rated by Moody's and S&P, the Fund's use of options and certain financial futures and options thereon will be subject to the limitations described under "Rating Agency Guidelines."

**Financial Futures Transactions and Options.** The Fund is authorized to purchase and sell certain exchange traded financial futures contracts ("financial futures contracts") in order to hedge its investments in Municipal Bonds against declines in value, and to hedge against increases in the cost of securities it intends to purchase or to seek to enhance the Fund's return. However, any transactions involving financial futures or options (including puts and calls associated therewith) will be in accordance with the Fund's investment policies and limitations. A financial futures contract obligates the seller of a contract to deliver and the purchaser of a contract to take delivery of the type of financial instrument covered by the contract, or in the case of index-based futures contracts to make and accept a cash settlement, at a specific future time for a specified price. To hedge its portfolio, the Fund may take an investment position in a futures contract which will move in the opposite direction from the portfolio position being hedged. A sale of financial futures contracts may provide a hedge against a decline in the value of portfolio securities because such depreciation may be offset, in whole or in part, by an increase in the value of the position in the financial futures contracts. A purchase of financial futures contracts may provide a hedge against an increase in the cost of securities intended to be purchased because such appreciation may be offset, in whole or in part, by an increase in the value of the position in the futures contracts.

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Distributions, if any, of net long term capital gains from certain transactions in futures or options are taxable at long term capital gains rates for Federal income tax purposes. See "Taxes."

**Futures Contracts.** A futures contract is an agreement between two parties to buy and sell a security or, in the case of an index-based futures contract, to make and accept a cash settlement for a set price on a future date. A majority of transactions in futures contracts, however, do not result in the actual delivery of the underlying instrument or cash settlement, but are settled through liquidation, i.e., by entering into an offsetting transaction. Futures contracts have been designed by boards of trade which have been designated "contracts markets" by the Commodity Futures Trading Commission ("CFTC").

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The purchase or sale of a futures contract differs from the purchase or sale of a security in that no price or premium is paid or received. Instead, an amount of cash or securities acceptable to the broker and the relevant contract market, which varies, but is generally about 5% of the contract amount, must be deposited with the broker. This amount is known as "initial margin" and represents a "good faith" deposit assuring the performance of both the purchaser and seller under the futures contract. Subsequent payments to and from the broker, called "variation margin," are required to be made on a daily basis as the price of the futures contract fluctuates making the long and short positions in the futures contract more or less valuable, a process known as "marking to the market." At any time prior to the settlement date of the futures contract, the position may be closed out by taking an opposite position that will operate to terminate the position in the futures contract. A final determination of variation margin is then made, additional cash is required to be paid to or released by the broker and the purchaser realizes a loss or gain. In addition, a nominal commission is paid on each completed sale transaction.

The Fund deals in financial futures contracts based on a long term municipal bond index developed by the Chicago Board of Trade ("CBT") and The Bond Buyer (the "Municipal Bond Index"). The Municipal Bond Index is comprised of 40 tax exempt municipal revenue and general obligation bonds. Each bond included in the Municipal Bond Index must be rated A or higher by Moody's or S&P and must have a remaining maturity of 19 years or more. Twice a month new issues satisfying the eligibility requirements are added to, and an equal number of old issues are deleted from, the Municipal Bond Index. The value of the Municipal Bond Index is computed daily according to a formula based on the price of each bond in the Municipal Bond Index, as evaluated by six dealer-to-dealer brokers.

The Municipal Bond Index futures contract is traded only on the CBT. Like other contract markets, the CBT assures performance under futures contracts through a clearing corporation, a nonprofit organization managed by the exchange membership which is also responsible for handling daily accounting of deposits or withdrawals of margin.

The Fund may also purchase and sell financial futures contracts on U.S. Government securities as a hedge against adverse changes in interest rates as described below. With respect to U.S. Government securities, currently there are financial futures contracts based on long term U.S. Treasury bonds, U.S. Treasury notes, Government National Mortgage Association ("GNMA") Certificates and three-month U.S. Treasury bills. The Fund may purchase and write call and

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put options on futures contracts on U.S. Government securities and purchase and sell Municipal Bond Index futures contracts in connection with its hedging strategies.

The Fund also may engage in other futures contracts transactions such as futures contracts on other municipal bond indices that may become available if the Investment Adviser should determine that there is normally a sufficient correlation between the prices of such futures contracts and the Municipal Bonds in which the Fund invests to make such hedging appropriate.

**Futures Strategies.** The Fund may sell a financial futures contract (i.e., assume a short position) in anticipation of a decline in the value of its investments in Municipal Bonds resulting from an increase in interest rates or otherwise. The risk of decline could be reduced without employing futures as a hedge by selling such Municipal Bonds and either reinvesting the proceeds in securities with shorter maturities or by holding assets in cash. This strategy, however, entails increased transaction costs in the form of dealer spreads and typically would reduce the average yield of the Fund's portfolio securities as a result of the shortening of maturities. The sale of futures contracts provides an alternative means of hedging against declines in the value of its investments in Municipal Bonds. As such values decline, the value of the Fund's positions in the futures contracts will tend to increase, thus offsetting all or a portion of the depreciation in the market value of the Fund's Municipal Bond investments that are being hedged. While the Fund will incur commission expenses in selling and closing out futures positions, commissions on futures transactions are lower than transaction costs incurred in the purchase and sale of Municipal Bonds. In addition, the ability of the Fund to trade in the standardized contracts available in the futures markets may offer a more effective defensive position than a program to reduce the average maturity of the portfolio securities due to the unique and varied credit and technical characteristics of the municipal debt instruments available to the Fund. Employing futures as a hedge also may permit the Fund to assume a defensive posture without reducing the yield on its investments beyond any amounts required to engage in futures trading.

When the Fund intends to purchase Municipal Bonds, the Fund may purchase futures contracts as a hedge against any increase in the cost of such Municipal Bonds resulting from a decrease in interest rates or otherwise, that

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may occur before such purchases can be effected. Subject to the degree of correlation between the Municipal Bonds and the futures contracts, subsequent increases in the cost of Municipal Bonds should be reflected in the value of the futures held by the Fund. As such purchases are made, an equivalent amount of futures contracts will be closed out. Due to changing market conditions and interest rate forecasts, however, a futures position may be terminated without a corresponding purchase of portfolio securities.

**Call Options on Futures Contracts.** The Fund may also purchase and sell exchange traded call and put options on financial futures contracts. The purchase of a call option on a futures contract is analogous to the purchase of a call option on an individual security. Depending on the pricing of the option compared to either the futures contract upon which it is based or the price of the underlying debt securities, it may or may not be less risky than ownership of the futures contract or underlying debt securities. Like the purchase of a futures contract, the Fund will purchase a call option on a futures contract to hedge against a market advance when the Fund is not fully invested.



The writing of a call option on a futures contract constitutes a partial hedge against declining prices of the securities which are deliverable upon exercise of the futures contract. If the futures price at expiration is below the exercise price, the Fund will retain the full amount of the option premium which provides a partial hedge against any decline that may have occurred in the Fund's portfolio holdings.

Put Options on Futures Contracts. The purchase of a put option on a futures contract is analogous to the purchase of a protective put option on portfolio securities. The Fund will purchase a put option on a futures contract to hedge the Fund's portfolio against the risk of rising interest rates.

The writing of a put option on a futures contract constitutes a partial hedge against increasing prices of the securities which are deliverable upon exercise of the futures contract. If the futures price at expiration is higher than the exercise price, the Fund will retain the full amount of the option premium which provides a partial hedge against any increase in the price of Municipal Bonds which the Fund intends to purchase.

The writer of an option on a futures contract is required to deposit initial and variation margin pursuant to requirements similar to those applicable to futures contracts. Premiums received from the writing of an option will be included in initial margin. The writing of an option on a futures contract involves risks similar to those relating to futures contracts.

Under regulations of the CFTC, the futures trading activity described herein will not result in the Fund being deemed a "commodity pool" and the Fund need not be operated by a person registered with the CFTC as a "commodity pool operator."

When the Fund purchases a futures contract, or writes a put option or purchases a call option thereon, an amount of cash, cash equivalents (e.g., high grade commercial paper and daily tender adjustable notes) or liquid securities will be segregated so that the amount so segregated, plus the amount of initial and variation margin held in the account of its broker, equals the market value of the futures contracts, thereby ensuring that the use of such futures contract is unleveraged. It is not anticipated that transactions in futures contracts will have the effect of increasing portfolio turnover.

Risk Factors in Futures Transactions and Options. Investment in futures contracts involves the risk of imperfect correlation between movements in the price of the futures contract and the price of the security being hedged. The hedge will not be fully effective when there is imperfect correlation between the movements in the prices of two financial instruments. For example, if the price of the futures contract moves more than the price of the hedged security, the Fund will experience either a loss or gain on the futures contract which is not completely offset by movements in the price of the hedged securities. To compensate for imperfect correlations, the Fund may purchase or sell futures contracts in a greater dollar amount than the hedged securities if the volatility of the hedged securities is historically greater than the volatility of the futures contracts. Conversely, the Fund may purchase or sell fewer futures contracts if the volatility of the price of the hedged securities is historically less than that of the futures contracts.

The particular municipal bonds comprising the index underlying the Municipal Bond Index financial futures contract may vary from the bonds held by the Fund. As a result, the Fund's ability to hedge effectively all or a portion of the value of its Municipal Bonds through the use of such financial futures contracts will depend in part on the degree to which price movements in the index underlying the financial futures contract correlate with the price movements of the Municipal Bonds held by the Fund. The correlation may be affected by disparities in the average maturity, ratings, geographical mix or structure of the Fund's investments as compared to those comprising the Municipal Bond Index and general economic or political factors. In addition, the correlation between movements in the value of the Municipal Bond Index may be subject to change over time as additions to and deletions from the Municipal Bond Index alter its structure. The correlation between futures contracts on U.S. Government securities and the Municipal Bonds held by the Fund may be adversely affected by similar factors and the risk of imperfect correlation between movements in the prices of such futures contracts and the prices of Municipal Bonds held by the Fund may be greater. Municipal Bond Index futures contracts were approved for trading in 1986. Trading in such futures contracts may tend to be less liquid than trading in other futures contracts. The trading of futures contracts also is subject to certain market risks, such as inadequate trading activity, which could at times make it difficult or impossible to liquidate existing positions.

The Fund expects to liquidate a majority of the futures contracts it enters into through offsetting transactions on the applicable contract market. There can be no assurance, however, that a liquid secondary market will exist for any particular futures contract at any specific time. Thus, it may not be possible to close out a futures position. In the event of adverse price movements, the Fund would continue to be required to make daily cash payments of variation margin. In such situations, if the Fund has insufficient cash, it may be required to sell portfolio securities to meet daily variation margin requirements at a time when it may be disadvantageous to do so. The inability to close out futures positions also could have an adverse impact on the Fund's ability to hedge effectively its investments in Municipal Bonds. The liquidity of a secondary market in a futures contract may be adversely affected by "daily price fluctuation limits" established by commodity exchanges which limit the amount of fluctuation in a futures contract price during a single trading day. Once the daily limit has been reached in the contract, no trades may be entered into at a price beyond the limit, thus preventing the liquidation of open futures positions. Prices have in the past moved beyond the daily limit on a number of consecutive trading days. The Fund will enter into a futures position only if, in the judgment of the Investment Adviser, there appears to be an actively traded secondary market for such futures contracts.

The successful use of transactions in futures and related options also depends on the ability of the Investment Adviser to forecast correctly the direction and extent of interest rate movements within a given time frame. To the extent interest rates remain stable during the period in which a futures contract or option is held by the Fund or such rates move in a direction opposite to that anticipated, the Fund may realize a loss on the hedging transaction which is not fully or partially offset by an increase in the value of portfolio securities. As a result, the Fund's total return for such period may be less than if it had not engaged in the hedging transaction.

Because of low initial margin deposits made upon the opening of a futures position, futures transactions involve substantial leverage. As a result, relatively small movements in the price of the futures contracts can result in substantial unrealized gains or losses. There is also the risk of loss by the Fund of margin deposits in the event of bankruptcy of a broker with whom the Fund has an open position in a financial futures contract. Because the Fund

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will engage in the purchase and sale of futures contracts for hedging purposes or to seek to enhance the Fund's return, any losses incurred in connection therewith should, if the hedging strategy is successful, be offset in whole or in part by increases in the value of securities held by the Fund or decreases in the price of securities the Fund intends to acquire.

The amount of risk the Fund assumes when it purchases an option on a futures contract is the premium paid for the option plus related transaction costs. In addition to the correlation risks discussed above, the purchase of an option on a futures contract also entails the risk that changes in the value of the underlying futures contract will not be fully reflected in the value of the option purchased.

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### OTHER INVESTMENT POLICIES

The Fund has adopted certain other policies as set forth below.

#### Temporary Investments

The Fund may invest in short term tax exempt and taxable securities subject to the limitations set forth above. The tax exempt money market securities may include municipal notes, municipal commercial paper, municipal bonds with a remaining maturity of less than one year, variable rate demand notes and participations therein. Municipal notes include tax anticipation notes, bond anticipation notes, revenue anticipation notes and grant anticipation notes. Anticipation notes are sold as interim financing in anticipation of tax collection, bond sales, government grants or revenue receipts. Municipal commercial paper refers to short term unsecured promissory notes generally issued to finance short term credit needs. The taxable money market securities in which the Fund may invest as Temporary Investments consist of U.S. Government securities, U.S. Government agency securities, domestic bank or savings institution certificates of deposit and bankers' acceptances, short term corporate debt securities such as commercial paper and repurchase agreements. These Temporary Investments must have a stated maturity not in excess of one year from the date of purchase. The Fund may not invest in any security issued by a commercial bank or a savings institution unless the bank or institution is organized and operating in the United States, has total assets of at least one billion dollars and is a member of the Federal Deposit Insurance Corporation ("FDIC"), except that up to 10% of total assets may be invested in certificates of deposit of smaller institutions if such certificates are fully insured by the FDIC.

#### Interest Rate Swap Transactions

In order to seek to hedge the value of the Fund against interest rate fluctuations, to hedge against increases in the Fund's costs associated with the dividend payments on any preferred stock, including the AMPS, or to seek to increase the Fund's return, the Fund may enter into interest rate swap transactions such as Municipal Market Data AAA Cash Curve swaps ("MMD Swaps") or Bond Market Association Municipal Swap Index swaps ("BMA Swaps"). To the extent that the Fund enters into these transactions, the Fund expects to do so primarily to preserve a return or spread on a particular investment or portion of its portfolio as a duration management technique or to protect against any increase in the price of securities the Fund anticipates purchasing at a later date. The Fund may enter into these transactions primarily as a hedge or for duration or risk management rather than as a speculative investment. However, the Fund also may invest in MMD Swaps and BMA Swaps to seek to enhance return

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or gain or to increase the Fund's yield, for example, during periods of steep interest rate yield curves (i.e., wide differences between short term and long term interest rates).

The Fund may purchase and sell BMA Swaps in the BMA swap market. In a BMA Swap, the Fund exchanges with another party their respective commitments to pay or receive interest (e.g., an exchange of fixed rate payments for floating rate payments linked to the Bond Market Association Municipal Swap Index). Because the underlying index is a tax exempt index, BMA Swaps may reduce cross-market risks incurred by the Fund and increase the Fund's ability to hedge effectively. BMA Swaps are typically quoted for the entire yield curve, beginning with a seven day floating rate index out to 30 years. The duration of a BMA Swap is approximately equal to the duration of a fixed rate Municipal Bond with the same attributes as the swap (e.g., coupon, maturity, call feature).

The Fund also may purchase and sell MMD Swaps, also known as MMD rate locks. An MMD Swap permits the Fund to lock in a specified municipal interest rate for a portion of its portfolio to preserve a return on a particular investment or a portion of its portfolio as a duration management technique or to protect against any increase in the price of securities to be purchased at a later date. By using an MMD Swap, the Fund can create a synthetic long or short position, allowing the Fund to select the most attractive part of the yield curve. An MMD Swap is a contract between the Fund and an MMD Swap provider pursuant to which the parties agree to make payments to each other on a notional amount, contingent upon whether the Municipal Market Data AAA General Obligation Scale is above or below a specified level on the expiration date of the contract. For example, if the Fund buys an MMD Swap and the Municipal Market Data AAA General Obligation Scale is below the specified level on the expiration date, the counterparty to the contract will make a payment to the Fund equal to the specified level minus the actual level, multiplied by the notional amount of the contract. If the Municipal Market Data AAA

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General Obligation Scale is above the specified level on the expiration date, the Fund will make a payment to the counterparty equal to the actual level minus the specified level, multiplied by the notional amount of the contract.

In connection with investments in BMA and MMD Swaps, there is a risk that municipal yields will move in the opposite direction than anticipated by the Fund, which would cause the Fund to make payments to its counterparty in the transaction that could adversely affect the Fund's performance.

The Fund has no obligation to enter into BMA or MMD Swaps and may not do so. The net amount of the excess, if any, of the Fund's obligations over its entitlements with respect to each interest rate swap will be accrued on a daily basis, and the Fund will segregate liquid securities having an aggregate net asset value at least equal to the accrued excess.

### Credit Default Swap Agreements

The Fund may enter into credit default swap agreements for hedging purposes or to seek to increase its return. The credit default swap agreement may have as reference obligations one or more securities that are not currently held by the Fund. The protection "buyer" in a credit default contract may be obligated to pay the protection "seller" an upfront or a periodic stream of payments over the term of the contract provided that no

credit event on a reference obligation has occurred. If a credit event occurs, the seller generally must pay the buyer the "par value" (full notional value) of the swap in exchange for an equal face amount of deliverable obligations of the reference entity described in the swap, or the seller may be required to deliver the related net cash amount, if the swap is cash settled. The Fund may be either the buyer or seller in the transaction. If the Fund is a buyer and no credit event occurs, the Fund may recover nothing if the swap is held through its termination date. However, if a credit event occurs, the buyer generally may elect to receive the full notional value of the swap in exchange for an equal face amount of deliverable obligations of the reference entity whose value may have significantly decreased. As a seller, the Fund generally receives an upfront payment or a fixed rate of income throughout the term of the swap, which typically is between six months and three years, provided that there is no credit event. If a credit event occurs, generally the seller must pay the buyer the full notional value of the swap in exchange for an equal face amount of deliverable obligations of the reference entity whose value may have significantly decreased. As the seller, the Fund would effectively add leverage to its portfolio because, in addition to its total net assets, the Fund would be subject to investment exposure on the notional amount of the swap.

Credit default swap agreements involve greater risks than if the Fund had invested in the reference obligation directly since, in addition to general market risks, credit default swaps are subject to illiquidity risk, counterparty risk and credit risks. The Fund will enter into credit default swap agreements only with counterparties who are rated investment grade quality by at least one nationally recognized statistical rating organization at the time of entering into such transaction or whose creditworthiness is believed by the Investment Adviser to be equivalent to such rating. A buyer generally also will lose its investment and recover nothing should no credit event occur and the swap is held to its termination date. If a credit event were to occur, the value of any deliverable obligation received by the seller, coupled with the upfront or periodic payments previously received, may be less than the full notional value it pays to the buyer, resulting in a loss of value to the seller. The Fund's obligations under a credit default swap agreement will be accrued daily (offset against any amounts owing to the Fund). The Fund will at all times segregate with its custodian in connection with each such transaction liquid securities or cash with a value at least equal to the Fund's exposure (any accrued but unpaid net amounts owed by the Fund to any counterparty), on a marked-to-market basis (as calculated pursuant to requirements of the Commission). Such segregation will ensure that the Fund has assets available to satisfy its obligations with respect to the transaction and will avoid any potential leveraging of the Fund's portfolio. Such segregation will not limit the Fund's exposure to loss.

#### VRDOs and Participating VRDOs

VRDOs are tax exempt obligations that contain a floating or variable interest rate adjustment formula and right of demand on the part of the holder thereof to receive payment of the unpaid principal balance plus accrued interest upon a short notice period not to exceed seven days. There is, however, the possibility that because of default or insolvency the demand feature of VRDOs and Participating VRDOs may not be honored. The interest rates are adjustable at intervals (ranging from daily to up to one year) to some prevailing market rate for similar investments, such adjustment formula being calculated to maintain the market value of the VRDOs, at

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approximately the par value of the VRDOs on the adjustment date. The adjustments typically are based upon the Public Securities Association Index or some other appropriate interest rate adjustment index. The Fund may invest in all types of tax exempt instruments currently outstanding or to be issued in the future which satisfy its short term maturity and quality standards.

Participating VRDOs provide the Fund with a specified undivided interest (up to 100%) of the underlying obligation and the right to demand payment of the unpaid principal balance plus accrued interest on the Participating VRDOs from the financial institution upon a specified number of days' notice, not to exceed seven days. In addition, the Participating VRDO is backed by an irrevocable letter of credit or guaranty of the financial institution. The Fund would have an undivided interest in the underlying obligation and thus participate on the same basis as the financial institution in such obligation except that the financial institution typically retains fees out of the interest paid on the obligation for servicing the obligation, providing the letter of credit and issuing the repurchase commitment. The Fund has been advised by its counsel that the Fund should be entitled to treat the income received on Participating VRDOs as interest from tax exempt obligations as long as the Fund does not invest more than 20% of its total assets in such investments and certain other conditions are met. It is contemplated that the Fund will not invest more than 20% of its assets in Participating VRDOs.

VRDOs that contain an unconditional right of demand to receive payment of the unpaid principal balance plus accrued interest on a notice period exceeding seven days may be deemed to be illiquid securities. The Directors may adopt guidelines and delegate to the Investment Adviser the daily function of determining and monitoring liquidity of such VRDOs. The Directors, however, will retain sufficient oversight and will be ultimately responsible for such determinations.

The Temporary Investments, VRDOs and Participating VRDOs in which the Fund may invest will be in the following rating categories at the time of purchase: MIG-1/VMIG-1 through MIG-3/VMIG-3 for notes and VRDOs and Prime-1 through Prime-3 for commercial paper (as determined by Moody's), SP-1 through SP-2 for notes and A-1 through A-3 for VRDOs and commercial paper (as determined by S&P), or F-1 through F-3 for notes, VRDOs and commercial paper (as determined by Fitch). Temporary Investments, if not rated, must be of comparable quality in the opinion of the Investment Adviser. In addition, the Fund reserves the right to invest temporarily a greater portion of its assets in Temporary Investments for defensive purposes, when, in the judgment of the Investment Adviser, market conditions warrant.

### Repurchase Agreements

The Fund may invest in securities pursuant to repurchase agreements. Repurchase agreements may be entered into only with a member bank of the Federal Reserve System or primary dealer or an affiliate thereof, in U.S. Government securities. Under such agreements, the bank or primary dealer or an affiliate thereof agrees, upon entering into the contract, to repurchase the security at a mutually agreed upon time and price, thereby determining the yield during the term of the agreement. This results in a fixed rate of return insulated from market fluctuations during such period. In repurchase agreements, the prices at which the trades are conducted do not reflect accrued interest on the underlying obligations. Such agreements usually cover short periods, such as under one week. Repurchase agreements may be construed to be collateralized loans by the purchaser to the seller secured by the securities transferred to the purchaser. In a repurchase agreement, the Fund will require the seller to provide additional collateral if the market value of the securities falls below the repurchase price at any time during the term of the repurchase agreement. In the event of default by the seller under a repurchase agreement construed to be a collateralized loan, the underlying

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securities are not owned by the Fund but only constitute collateral for the seller's obligation to pay the repurchase price. Therefore, the Fund may suffer time delays and incur costs or possible losses in connection with the disposition of the collateral. In the event of a default under such a repurchase agreement, instead of the contractual fixed rate of return, the rate of return to the Fund shall be dependent upon intervening fluctuations of the market value of such security and the accrued interest on the security. In such event, the Fund would have rights against the seller for breach of contract with respect to any losses arising from market fluctuations following the failure of the seller to perform.

In general, for Federal income tax purposes, repurchase agreements are treated as collateralized loans secured by the securities "sold." Therefore, amounts earned under such agreements will not be considered tax exempt interest. The treatment of purchase and sales contracts is less certain.

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### Borrowings

The Fund is authorized to borrow money in amounts of up to 5% of the value of its total assets at the time of such borrowings; provided, however, that the Fund is authorized to borrow moneys in amounts of up to 33% of the value of its total assets at the time of such borrowings to finance the repurchase of its own common stock pursuant to tender offers or otherwise to redeem or repurchase shares of preferred stock. Borrowings by the Fund (commonly known, as with the issuance of preferred stock, as "leveraging") create an opportunity for greater total return since, for example, the Fund will not be required to sell portfolio securities to repurchase or redeem shares but, at the same time, increase exposure to capital risk. In addition, borrowed funds are subject to interest costs that may offset or exceed the return earned on the borrowed funds.

### DESCRIPTION OF AMPS

Certain of the capitalized terms used herein not otherwise defined in this prospectus have the meaning provided in the Glossary at the back of this prospectus.

### General

The Series C AMPS will be shares of preferred stock that entitle their holders to receive dividends when, as and if declared by the Board of Directors, out of funds legally available therefor, at a rate per annum that may vary for the successive Dividend Periods. After the Initial Dividend Period, each Subsequent Dividend Period for the Series C AMPS generally will be a 7-Day Dividend Period; provided however, that, prior to any Auction, the Fund may elect, subject to certain limitations described herein, upon giving notice to holders thereof, a Special Dividend Period. The Applicable Rate for a particular Dividend Period will be determined by an Auction conducted on the Business Day before the start of such Dividend Period. Beneficial Owners and Potential Beneficial Owners of shares of AMPS may participate in Auctions therefor, although, except in the case of a Special Dividend Period of more than 28 days, Beneficial Owners desiring to continue to hold all of their shares of AMPS regardless of the Applicable Rate resulting from Auctions need not participate. For an explanation of Auctions and the method of determining the Applicable Rate, see "The Auction" herein and in the statement of additional information.

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The Fund has outstanding 3,900 shares of two other series of Auction Market Preferred Stock, each with a liquidation preference of \$25,000 per share, plus accumulated but unpaid dividends, for an aggregate initial liquidation preference of \$97,500,000 (the "Other AMPS"). The Other AMPS are as follows: 2,400 shares of Auction Market Preferred Stock, Series A; and 1,500 shares of Auction Market Preferred Stock, Series B. The Series C AMPS offered hereby rank on a parity with the Other AMPS with respect to dividends and liquidation preference. The terms of the shares of Other AMPS are substantially the same as the terms of the shares of AMPS described below.

The following is a brief description of the terms of the shares of AMPS. This description does not purport to be complete and is subject to and qualified in its entirety by reference to the Fund's Charter and Articles Supplementary of the AMPS, including the provisions thereof establishing the AMPS. The Fund's Charter and the form of Articles Supplementary of the AMPS establishing the terms of the AMPS have been filed as exhibits to the Registration Statement of which this prospectus is a part.

### Dividends

General. The holders of shares of AMPS will be entitled to receive, when, as and if declared by the Board of Directors of the Fund, out of funds legally available therefor, cumulative cash dividends on their shares, at the Applicable Rate determined as set forth below under "Determination of Dividend Rate," payable on the respective dates set forth below. Dividends on the shares of AMPS so declared and payable shall be paid (i) in preference to and in priority over any dividends so declared and payable on the Fund's common stock, and (ii) to the extent permitted under the Code, and to the extent available, out of net tax exempt income earned on the Fund's investments. Generally, dividends on shares of AMPS, to the extent that they are derived from interest paid on New Jersey Municipal Bonds, will be exempt from Federal income taxes, subject to possible application of the alternative minimum tax and New Jersey personal income tax, and to the extent that they are derived from interest paid on

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Municipal Bonds, will be exempt from Federal income taxes, subject to possible application of the alternative minimum tax. See "Taxes."

Dividends on the shares of AMPS will accumulate from the date on which the Fund originally issues the shares of AMPS (the "Date of Original Issue") and will be payable on the dates described below. Dividends on shares of AMPS with respect to the Initial Dividend Period shall be payable on the Initial Dividend Payment Date. Following the Initial Dividend Payment Date for the AMPS, dividends on the AMPS will be payable, at the option of the Fund, either (i) with respect to any 7-Day Dividend Period and any Short Term Dividend Period of 35 or fewer days, on the day next succeeding the last day thereof or (ii) with respect to any Short Term Dividend Period of more than 35 days and with respect to any Long Term Dividend Period, monthly on the first Business Day of each calendar month during such Short Term Dividend Period or Long Term Dividend Period and on the day next succeeding the last day thereof (each such date referred to in clause (i) or (ii) being referred to herein as a "Normal Dividend Payment Date"), except that if such Normal Dividend Payment Date is not a Business Day, the Dividend Payment Date shall be the first Business Day next succeeding such Normal Dividend Payment Date. Thus, following the Initial Dividend Payment Date for AMPS, dividends generally will be payable (in the case of Dividend Periods which are not Special Dividend Periods) on each succeeding Tuesday in the case of the Series C AMPS. Although any particular



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Dividend Payment Date may not occur on the originally scheduled date because of the exceptions discussed above, the next succeeding Dividend Payment Date, subject to such exceptions, will occur on the next following originally scheduled date. If for any reason a Dividend Payment Date cannot be fixed as described above, then the Board of Directors shall fix the Dividend Payment Date. The Board of Directors by resolution prior to authorization of a dividend by the Board of Directors may change a Dividend Payment Date if such change does not adversely affect the contract rights of the holders of shares of AMPS set forth in the Charter. The Initial Dividend Period, 7-Day Dividend Periods and Special Dividend Periods are hereinafter sometimes referred to as "Dividend Periods." Each dividend payment date determined as provided above is hereinafter referred to as a "Dividend Payment Date."

Prior to each Dividend Payment Date, the Fund is required to deposit with the Auction Agent sufficient funds for the payment of declared dividends. The Fund does not intend to establish any reserves for the payment of dividends.

Each dividend will be paid to the record holder of the AMPS, which holder is expected to be the nominee of the Securities Depository. See "The Auction--Securities Depository." The Securities Depository will credit the accounts of the Agent Members of the Existing Holders in accordance with the Securities Depository's normal procedures which provide for payment in same-day funds. The Agent Member of an Existing Holder will be responsible for holding or disbursing such payments on the applicable Dividend Payment Date to such Existing Holder in accordance with the instructions of such Existing Holder. Dividends in arrears for any past Dividend Period may be declared and paid at any time, without reference to any regular Dividend Payment Date, to the nominee of the Securities Depository. Any dividend payment made on shares of AMPS first shall be credited against the earliest declared but unpaid dividends accumulated with respect to such shares.

Holders of shares of AMPS will not be entitled to any dividends, whether payable in cash, property or stock, in excess of full cumulative dividends except as described below under "--Additional Dividends" in this prospectus and under "Description of AMPS--Dividends--Non-Payment Period; Late Charge" in the statement of additional information. No interest will be payable in respect of any dividend payment or payments on the shares of AMPS that may be in arrears.

The amount of cash dividends per share of the AMPS payable (if declared) on the Initial Dividend Payment Date, and on each Dividend Payment Date of each 7-Day Dividend Period and each Short Term Dividend Period, shall be computed by multiplying the Applicable Rate for such Dividend Period by a fraction, the numerator of which will be the number of days in such Dividend Period or part thereof that such share was outstanding and for which dividends are payable on such Dividend Payment Date and the denominator of which will be 365, multiplying the amount so obtained by \$25,000, and rounding the amount so obtained to the nearest cent. During any Long Term Dividend Period, the amount of cash dividends per share of AMPS payable (if declared) on any Dividend Payment Date shall be computed by multiplying the Applicable Rate for such Dividend Period by a fraction, the numerator of which will be such number of days in such part of such Dividend Period that such share was outstanding and for

which dividends are payable on such Dividend Payment Date and the denominator of which will be 360, multiplying the amount so obtained by \$25,000, and rounding the amount so obtained to the nearest cent.

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Notification of Dividend Period. With respect to each Dividend Period that is a Special Dividend Period, the Fund, at its sole option and to the extent permitted by law, by telephonic and written notice (a "Request for Special Dividend Period") to the Auction Agent and to each Broker-Dealer, may request that the next succeeding Dividend Period for the AMPS will be a number of days (other than seven), evenly divisible by seven, and not fewer than seven nor more than 364 in the case of a Short Term Dividend Period or one whole year or more but not greater than five years in the case of a Long Term Dividend Period, specified in such notice, provided that the Fund may not give a Request for Special Dividend Period (and any such request shall be null and void) unless, for any Auction occurring after the initial Auction, Sufficient Clearing Bids were made in the last occurring Auction and unless full cumulative dividends and any amounts due with respect to redemptions, and any Additional Dividends payable prior to such date have been paid in full. Such Request for Special Dividend Period, in the case of a Short Term Dividend Period, shall be given on or prior to the second Business Day but not more than seven Business Days prior to an Auction Date for the AMPS and, in the case of a Long Term Dividend Period, shall be given on or prior to the second Business Day but not more than 28 days prior to an Auction Date for the AMPS. Upon receiving such Request for Special Dividend Period, the Broker-Dealers jointly shall determine whether, given the factors set forth below, it is advisable that the Fund issue a Notice of Special Dividend Period for the AMPS as contemplated by such Request for Special Dividend Period and the Optional Redemption Price of the AMPS during such Special Dividend Period and the Specific Redemption Provisions and shall give the Fund written notice (a "Response") of such determination by no later than the second Business Day prior to such Auction Date. In the event the Response indicates that it is advisable that the Fund give a notice of a Special Dividend Period for the AMPS, the Fund, by no later than the second Business Day prior to such Auction Date may give a notice (a "Notice of Special Dividend Period") to the Auction Agent, the Securities Depository and each Broker-Dealer. See "Description of AMPS--Dividends--Notification of Dividend Period" in the statement of additional information for a detailed description of these procedures.

Determination of Dividend Rate. The dividend rate on shares of the AMPS during the period from and including the Date of Original Issue for the Series C AMPS to but excluding the Initial Dividend Payment Date (the "Initial Dividend Period") with respect to the Series C AMPS will be the rate per annum set forth above under "Prospectus Summary--Dividends and Dividend Periods." Commencing on the Initial Dividend Payment Date for the Series C AMPS, the Applicable Rate on the Series C AMPS for each Subsequent Dividend Period, which Subsequent Dividend Period shall be a period commencing on and including a Dividend Payment Date and ending on and including the calendar day prior to the next Dividend Payment Date (or calendar day prior to the last Dividend Payment Date in a Dividend Period if there is more than one Dividend Payment Date), shall be equal to the rate per annum that results from the Auction with respect to such Subsequent Dividend Period. The Initial Dividend Period and Subsequent Dividend Period for the AMPS is referred to herein as a "Dividend Period." Cash dividends shall be calculated as set forth above under "Dividends--General."

Restrictions on Dividends and Other Payments. Under the 1940 Act, the Fund may not declare dividends or make other distributions on shares of common stock or purchase any such shares if, at the time of the declaration, distribution or purchase, as applicable (and after giving effect thereto), asset coverage (as defined in the 1940 Act) with respect to the outstanding shares of AMPS (and Other AMPS) would be less than 200% (or such other percentage as in the future may be required by law). The Fund estimates that, based on the composition of its portfolio at May 31, 2004, asset coverage with respect to shares of AMPS would be approximately [ ]% representing approximately [ ]% of the Fund's capital and [ ]% of the Fund's common stock

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equity immediately after the issuance of the shares of AMPS offered hereby. Under the Code, the Fund, among other things, must distribute at least 90% of its investment company taxable income each year in order to maintain its qualification for tax treatment as a regulated investment company. The foregoing limitations on dividends, distributions and purchases under certain circumstances may impair the Fund's ability to maintain such qualification. See "Taxes" in the statement of additional information.

Upon any failure to pay dividends on shares of AMPS for two years or more, the holders of the shares of AMPS will acquire certain additional voting rights. See "Voting Rights" below. Such rights shall be the exclusive remedy of the holders of shares of AMPS upon any failure to pay dividends on shares of the Fund.

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Additional Dividends. If the Fund retroactively allocates any net capital gain or other income subject to regular Federal income taxes to shares of AMPS without having given advance notice thereof to the Auction Agent as described under "The Auction--Auction Procedures--Auction Date; Advance Notice of Allocation of Taxable Income; Inclusion of Taxable Income in Dividends" below, which may only happen when such allocation is made as a result of the redemption of all or a portion of the outstanding shares of AMPS or the liquidation of the Fund (the amount of such allocation referred to herein as a "Retroactive Taxable Allocation"), the Fund, within 90 days (and generally within 60 days) after the end of the Fund's fiscal year for which a Retroactive Taxable Allocation is made, will provide notice thereof to the Auction Agent and to each holder of shares (initially Cede as nominee of the Securities Depository) during such fiscal year at such holder's address as the same appears or last appeared on the stock books of the Fund. The Fund, within 30 days after such notice is given to the Auction Agent, will pay to the Auction Agent (who then will distribute to such holders of shares of AMPS), out of funds legally available therefor, an amount equal to the aggregate Additional Dividend (as defined below) with respect to all Retroactive Taxable Allocations made to such holders during the fiscal year in question.

An "Additional Dividend" means payment to a present or former holder of shares of AMPS of an amount which, when taken together with the aggregate amount of Retroactive Taxable Allocations made to such holder with respect to the fiscal year in question, would cause such holder's dividends in dollars (after Federal and New Jersey income tax consequences) from the aggregate of both the Retroactive Taxable Allocations and the Additional Dividend to be equal to the dollar amount of the dividends which would have been received by such holder if the amount of the aggregate Retroactive Taxable Allocations had been excludable from the gross income of such holder. Such Additional Dividend shall be calculated (i) without consideration being given to the time value of money; (ii) assuming that no holder of shares of AMPS is subject to the Federal alternative minimum tax with respect to dividends received from the Fund; and (iii) assuming that each Retroactive Taxable Allocation would be taxable in the hands of each holder of shares of AMPS at the greater of: (a) the maximum combined marginal regular Federal and New Jersey individual income tax rate applicable to ordinary income or capital gains depending on the taxable character of the distribution (including any surtax); or (b) the maximum combined marginal regular Federal and New Jersey corporate income tax rate applicable to ordinary income or capital gains depending on the taxable character of the distribution (taking into account in both (a) and (b) the Federal income tax deductibility of state and local taxes paid or incurred but not any phase out of, or provision limiting, personal exemptions, itemized deductions, or the benefit of lower tax brackets and assuming the taxability

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of Federally tax exempt dividends for corporations for New Jersey income tax purposes). Although the Fund generally intends to designate any Additional Dividend as an exempt-interest dividend to the extent permitted by applicable law, it is possible that all or a portion of any Additional Dividend will be taxable to the recipient thereof. See "Taxes" in the statement of additional information. The Fund will not pay a further Additional Dividend with respect to any taxable portion of an Additional Dividend.

If the Fund does not give advance notice of the amount of taxable income to be included in a dividend on shares of AMPS in the related Auction, the Fund may include such taxable income in a dividend on shares of AMPS if it increases the dividend by an additional amount calculated as if such income were a Retroactive Taxable Allocation and the additional amount were an Additional Dividend and notifies the Auction Agent of such inclusion at least five Business Days prior to the applicable Dividend Payment Date. See "The Auction--Auction Procedures--Auction Date; Advance Notice of Allocation of Taxable Income; Inclusion of Taxable Income in Dividends" below.

### Asset Maintenance

The Fund will be required to satisfy two separate asset maintenance requirements under the terms of the Articles Supplementary. These requirements are summarized below.

1940 Act AMPS Asset Coverage. The Fund will be required under the Articles Supplementary to maintain, with respect to shares of AMPS, as of the last Business Day of each month in which any shares of AMPS are outstanding, asset coverage of at least 200% with respect to senior securities that are stock, including the shares of AMPS and Other AMPS (or such other asset coverage as in the future may be specified in or under the 1940 Act as the minimum asset coverage for senior securities that are stock of a closed-end investment company as a condition of paying dividends on its common stock) ("1940 Act AMPS Asset Coverage"). If the Fund fails to maintain 1940 Act AMPS Asset Coverage and such failure is not cured as of the last Business Day of the following month (the

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"1940 Act Cure Date"), the Fund will be required under certain circumstances to redeem certain of the shares of AMPS. See "Redemption" below.

Based upon the composition of the Fund's portfolio at May 31, 2004, the 1940 Act AMPS Asset Coverage immediately following the issuance of AMPS offered hereby (after giving effect to the deduction of the underwriting discount and offering expenses for the shares of AMPS) will be computed as follows:

Value of Fund assets less liabilities not constituting senior securities	=	\$
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Senior securities representing indebtedness plus liquidation value of the shares of AMPS		\$

AMPS Basic Maintenance Amount. So long as shares of AMPS are outstanding, the Fund will be required under the Articles Supplementary to maintain as of the last Business Day of each week (a "Valuation Date") Moody's Eligible Assets and S&P Eligible Assets each having in the aggregate a Discounted Value at least equal to the AMPS Basic Maintenance Amount. The AMPS Basic Maintenance Amount includes the sum of (i) the aggregate liquidation value of AMPS and Other AMPS then outstanding and (ii) certain accrued and projected payment obligations of the Fund. See "Description of AMPS--Asset Maintenance--AMPS Basic Maintenance Amount" in the statement of additional information. If the Fund fails to meet such requirement as of any Valuation Date and such failure is not cured on or before the sixth Business Day after such Valuation Date (the "AMPS Basic Maintenance Cure Date"), the Fund will be required under certain circumstances to redeem certain of the shares of AMPS. Upon any failure to maintain the required Discounted Value, the Fund will use its best efforts to alter the composition of its portfolio to reattain a Discounted Value at least equal to the AMPS Basic Maintenance Amount on or prior to the AMPS Basic Maintenance Cure Date. See "Redemption" herein and in the statement of additional information.

#### Redemption

Optional Redemption. To the extent permitted under the 1940 Act and under Maryland law, upon giving a Notice of Redemption, as provided in the statement of additional information, the Fund, at its option, may redeem shares of AMPS, in whole or in part, out of funds legally available therefor, at the Optional Redemption Price per share on any Dividend Payment Date; provided that no share of AMPS may be redeemed at the option of the Fund during (a) the Initial Dividend Period with respect to such share or (b) a Non-Call Period to which such share is subject. "Optional Redemption Price" means \$25,000 per share of AMPS plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) to the date fixed for redemption plus any applicable redemption premium, if any, attributable to the designation of a Premium Call Period. In addition, holders of AMPS may be entitled to receive Additional Dividends in the event of redemption of such AMPS to the extent provided herein. See "Dividends--Additional Dividends." The Fund has the authority to redeem the AMPS for any reason and may redeem all or part of the outstanding shares of AMPS if it anticipates that the Fund's leveraged capital structure will result in a lower rate of return to holders of common stock for any significant period of time than that obtainable if the common stock were unleveraged.

Mandatory Redemption. The Fund will be required to redeem, out of funds legally available therefor, at the Mandatory Redemption Price per share, shares of AMPS to the extent permitted under the 1940 Act and Maryland law, on a date fixed by the Board of Directors, if the Fund fails to maintain Moody's Eligible Assets and S&P Eligible Assets each with an aggregate Discounted Value equal to or greater than the AMPS Basic Maintenance Amount or to satisfy the 1940 Act AMPS Asset Coverage and such failure is not cured on or before the AMPS Basic Maintenance Cure Date or the 1940 Act Cure Date (herein collectively referred to as a "Cure Date"), as the case may be. "Mandatory Redemption Price" means \$25,000 per share of AMPS plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) to the date fixed for redemption. In addition, holders of AMPS may be entitled to receive Additional Dividends in the event of redemption of such AMPS to the extent provided herein. See "Dividends--Additional Dividends."

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For a discussion of the allocation procedures to be used if fewer than all of the outstanding shares of AMPS are to be redeemed and for a discussion of other redemption procedures, see "Description of AMPS--Redemption" in the statement of additional information.

### Liquidation Rights

Upon any liquidation, dissolution or winding up of the Fund, whether voluntary or involuntary, the holders of shares of AMPS will be entitled to receive, out of the assets of the Fund available for distribution to stockholders, before any distribution or payment is made upon any shares of common stock or any other capital stock of the Fund ranking junior in right of payment upon liquidation of AMPS, \$25,000 per share together with the amount of any dividends accumulated but unpaid (whether or not earned or declared) thereon to the date of distribution, and after such payment the holders of AMPS will be entitled to no other payments except for Additional Dividends. If such assets of the Fund shall be insufficient to make the full liquidation payment on the outstanding shares of AMPS and liquidation payments on any other outstanding class or series of preferred stock of the Fund ranking on a parity with the AMPS as to payment upon liquidation, including the Other AMPS, then such assets will be distributed among the holders of such shares of AMPS and the holders of shares of such other class or series, including the Other AMPS, ratably in proportion to the respective preferential amounts to which they are entitled. After payment of the full amount of liquidation distribution to which they are entitled, the holders of AMPS will not be entitled to any further participation in any distribution of assets by the Fund. A consolidation, merger or share exchange of the Fund with or into any other entity or entities or a sale, whether for cash, shares of stock, securities or properties, of all or substantially all or any part of the assets of the Fund shall not be deemed or construed to be a liquidation, dissolution or winding up of the Fund.

### Voting Rights

Except as otherwise indicated in this prospectus and the statement of additional information and except as otherwise required by applicable law, holders of shares of AMPS will be entitled to one vote per share on each matter submitted to a vote of stockholders of the Fund and will vote together with holders of shares of Other AMPS and holders of shares of common stock as a single class.

The 1940 Act and the Articles Supplementary require that the holders of preferred stock, including the AMPS and Other AMPS, voting as a separate class, have the rights to elect two of the Fund's Directors at all times and to elect a majority of the Directors at any time that two full years' dividends on the AMPS (and Other AMPS) are unpaid. The holders of AMPS (and Other AMPS) will vote as a separate class or classes on certain other matters as required under the Articles Supplementary, the 1940 Act and Maryland law. In addition, the Series C AMPS (and Other AMPS) may vote as a separate series under certain circumstances. See "Description of AMPS--Voting Rights" in the statement of additional information.

### THE AUCTION

Certain of the capitalized terms used herein not otherwise defined in this prospectus have the meaning provided in the Glossary at the back of this prospectus.

### General

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Holders of the shares of the Series C AMPS will be entitled to receive cumulative cash dividends on their shares when, as and if declared by the Board of Directors of the Fund, out of funds legally available therefor, on the Initial Dividend Payment Date with respect to the Initial Dividend Period and, thereafter, on each Dividend Payment Date with respect to a Subsequent Dividend Period (generally a period of seven days, subject to certain exceptions set forth under "Description of AMPS--Dividends--General") at the rate per annum equal to the Applicable Rate for each such Dividend Period.

The provisions of the Articles Supplementary establishing the terms of the shares of AMPS offered hereby will provide that the Applicable Rate for the Series C AMPS for each Dividend Period after the Initial Dividend Period therefor will be equal to the rate per annum that the Auction Agent advises has resulted on the Business Day

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preceding the first day of such Dividend Period due to implementation of the auction procedures set forth in the Articles Supplementary (the "Auction Procedures") in which persons determine to hold or offer to purchase or sell shares of AMPS. The Auction Procedures are attached as Appendix D to the statement of additional information.

Each periodic operation of such procedures with respect to the shares of AMPS is referred to hereinafter as an "Auction." If, however, the Fund should fail to pay or duly provide for the full amount of any dividend on shares of AMPS or the redemption price of shares of AMPS called for redemption, the Applicable Rate for shares of AMPS will be determined as set forth under "Description of AMPS--Dividends--Non-Payment Period; Late Charge" in the statement of additional information.

Auction Agent Agreement. The Fund has entered into an agreement with The Bank of New York (together with any successor bank or trust company or other entity entering into a similar agreement with this Fund, the "Auction Agent") (the "Auction Agent Agreement"), which provides, among other things, that the Auction Agent will follow the Auction Procedures for the purpose of determining the Applicable Rate for the AMPS. The Fund will pay the Auction Agent compensation for its services under the Auction Agent Agreement.

Broker-Dealer Agreements. The Auction Agent has entered into agreements with Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") and more than twenty other broker-dealers and may enter into similar agreements (collectively, the "Broker-Dealer Agreements") with one or more other broker-dealers (collectively, the "Broker-Dealers") selected by the Fund, which provide for the participation of such Broker-Dealers in Auctions. Merrill Lynch is an affiliate of the Investment Adviser in that they share a common parent, Merrill Lynch & Co., Inc.

Securities Depository. The Depository Trust Company initially will act as the Securities Depository for the Agent Members with respect to the shares of the Series C AMPS. One or more registered certificates for all of the shares of the Series C AMPS initially will be registered in the name of Cede, as nominee of the Securities Depository. The certificate will bear a legend to the effect that such certificate is issued subject to the provisions restricting transfers of shares of AMPS to which it relates contained in the Articles Supplementary. Cede initially will be the holder of record of all shares of AMPS, and Beneficial Owners will not be entitled to receive certificates representing their ownership interest in such shares. The Securities Depository will maintain lists of its participants and will

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maintain the positions (ownership interests) of shares of AMPS held by each Agent Member, whether as the Beneficial Owner thereof for its own account or as nominee for the Beneficial Owner thereof. Payments made by the Fund to holders of AMPS will be duly made by making payments to the nominee of the Securities Depository.

### Auction Procedures

The following is a brief discussion of the procedures to be used in conducting Auctions. This summary is qualified by reference to the Auction Procedures set forth in Appendix D to the statement of additional information. The Settlement Procedures to be used with respect to Auctions are set forth in Appendix C to the statement of additional information.

Auction Date; Advance Notice of Allocation of Taxable Income; Inclusion of Taxable Income in Dividends. An Auction to determine the Applicable Rate for the shares of the Series C AMPS offered hereby for each Dividend Period (other than the Initial Dividend Period therefor) will be held on the first Business Day (as hereinafter defined) preceding the first day of such Dividend Period, which first day is also a Dividend Payment Date for the preceding Dividend Period (the date of each Auction being referred to herein as an "Auction Date"). "Business Day" means a day on which the New York Stock Exchange (the "NYSE") is open for trading and which is not a Saturday, Sunday or other day on which banks in the City of New York are authorized or obligated by law to close. Auctions for shares of the Series C AMPS for Dividend Periods after the Initial Dividend Period normally will be held every Monday after the preceding Dividend Payment Date, and each subsequent Dividend Period normally will begin on the following Tuesday (also a Dividend Payment Date). The Auction Date and the first day of the related Dividend Period (both of which must be Business Days) need not be consecutive calendar days. For example, in most cases, if the Monday that normally would be an Auction Date for the Series C AMPS is not a Business Day, then such Auction Date will be the preceding Friday and the first day of the related Dividend Period will continue to be the following Tuesday. See "Description of AMPS -- Dividends" for information concerning the circumstances under

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which a Dividend Payment Date may fall on a date other than the days specified above, which may affect the Auction Date.

Except as noted below, whenever the Fund intends to include any net capital gain or other income subject to regular Federal income taxes in any dividend on shares of AMPS, the Fund will notify the Auction Agent of the amount to be so included at least five Business Days prior to the Auction Date on which the Applicable Rate for such dividend is to be established. Whenever the Auction Agent receives such notice from the Fund, in turn it will notify each Broker-Dealer, who, on or prior to such Auction Date, in accordance with its Broker-Dealer Agreement, will notify its customers who are Beneficial Owners and Potential Beneficial Owners believed to be interested in submitting an Order in the Auction to be held on such Auction Date. The Fund also may include such income in a dividend on shares of AMPS without giving advance notice thereof if it increases the dividend by an additional amount calculated as if such income were a Retroactive Taxable Allocation and the additional amount were an Additional Dividend; provided that the Fund will notify the Auction Agent of the additional amounts to be included in such dividend at least five Business Days prior to the applicable Dividend Payment Date. See "Description of AMPS--Dividends--Additional Dividends" above.



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Orders by Beneficial Owners, Potential Beneficial Owners, Existing Holders and Potential Holders. On or prior to each Auction Date:

(a) each Beneficial Owner may submit to its Broker-Dealer by telephone a:

(i) Hold Order -- indicating the number of outstanding shares, if any, of AMPS that such Beneficial Owner desires to continue to hold without regard to the Applicable Rate for the next Dividend Period for such shares;

(ii) Bid -- indicating the number of outstanding shares, if any, of AMPS that such Beneficial Owner desires to continue to hold, provided that the Applicable Rate for the next Dividend Period for such shares is not less than the rate per annum then specified by such Beneficial Owner; and/or

(iii) Sell Order -- indicating the number of outstanding shares, if any, of AMPS that such Beneficial Owner offers to sell without regard to the Applicable Rate for the next Dividend Period for such shares; and

(b) Broker-Dealers will contact customers who are Potential Beneficial Owners of shares of AMPS to determine whether such Potential Beneficial Owners desire to submit Bids indicating the number of shares of AMPS which they offer to purchase provided that the Applicable Rate for the next Dividend Period for such shares is not less than the rates per annum specified in such Bids.

The communication by a Beneficial Owner or Potential Beneficial Owner to a Broker-Dealer and the communication by a Broker-Dealer, whether or not acting for its own account, to the Auction Agent of the foregoing information is hereinafter referred to as an "Order" and collectively as "Orders." A Beneficial Owner or a Potential Beneficial Owner placing an Order, including a Broker-Dealer acting in such capacity for its own account, is hereinafter referred to as a "Bidder" and collectively as "Bidders." Any Order submitted by a Beneficial Owner or a Potential Beneficial Owner to its Broker-Dealer, or by a Broker-Dealer to the Auction Agent, prior to the Submission Deadline on any Auction Date shall be irrevocable.

In an Auction, a Beneficial Owner may submit different types of Orders with respect to shares of AMPS then held by such Beneficial Owner, as well as Bids for additional shares of AMPS. For information concerning the priority given to different types of Orders placed by Beneficial Owners, see "Submission of Orders by Broker-Dealers to Auction Agent" below.

The Maximum Applicable Rate for shares of AMPS will be the higher of (A) the Applicable Percentage of the Reference Rate or (B) the Applicable Spread plus the Reference Rate. The Auction Agent will round each applicable Maximum Applicable Rate to the nearest one-thousandth (0.001) of one percent per annum, with any

such number ending in five ten-thousandths of one percent being rounded upwards to the nearest one-thousandth (0.001) of one percent. The Auction Agent will not round the applicable Reference Rate as part of its calculation of the Maximum Applicable Rate.

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The Maximum Applicable Rate for shares of AMPS will depend on the credit rating or ratings assigned to such shares. The Applicable Percentage and the Applicable Spread will be determined based on (i) the lower of the credit rating or ratings assigned on such date to such shares by Moody's and S&P (or if Moody's or S&P or both shall not make such rating available, the equivalent of either or both of such ratings by a Substitute Rating Agency or two Substitute Rating Agencies or, in the event that only one such rating shall be available, such rating) and (ii) whether the Fund has provided notification to the Auction Agent prior to the Auction establishing the Applicable Rate for any dividend that net capital gain or other taxable income will be included in such dividend on shares of AMPS as follows:

Credit Ratings		Applicable Percentage	Applicable Percentage	Ap
		of Reference Rate--No Notification	of Reference Rate--Notification	R
Moody's	S&P			Not
Aaa	AAA	110%	125%	
Aa3 to Aa1	AA- to AA+	125%	150%	
A3 to A1	A- to A+	150%	200%	
Baa3 to Baa1	BBB- to BBB+	175%	250%	
Below Baa3	Below BBB-	200%	300%	

There is no minimum Applicable Rate in respect of any Dividend Period.

The Applicable Percentage and the Applicable Spread as so determined may be further subject to upward but not downward adjustment in the discretion of the Board of Directors of the Fund after consultation with the Broker-Dealers, provided that immediately following any such increase, the Fund would be in compliance with the AMPS Basic Maintenance Amount. The Fund will take all reasonable action necessary to enable either S&P or Moody's, or both to provide a rating for the AMPS, subject to the Fund's ability to terminate compliance with the rating agency guidelines as discussed under "Rating Agency Guidelines." If either S&P or Moody's, or both, shall not make such a rating available, and subject to the Fund's ability to terminate compliance with the rating agency guidelines discussed under "Rating Agency Guidelines," Merrill Lynch or its affiliates and successors, after obtaining the Fund's approval, will select another NRSRO (a "Substitute Rating Agency") or two other NRSROs ("Substitute Rating Agencies") to act as a Substitute Rating Agency or Substitute Rating Agencies, as the case may be.

Any Bid by a Beneficial Owner specifying a rate per annum higher than the Maximum Applicable Rate will be treated as a Sell Order, and any Bid by a Potential Beneficial Owner specifying a rate per annum higher than the Maximum Applicable Rate will not be considered. See "Determination of Sufficient Clearing Bids, Winning Bid Rate and Applicable Rate" and "Acceptance and Rejection of Submitted Bids and Submitted Sell Orders and Allocation of Shares."

Neither the Fund nor the Auction Agent will be responsible for a Broker-Dealer's failure to comply with the foregoing.

A Broker-Dealer also may hold AMPS in its own account as a Beneficial Owner. A Broker-Dealer thus may submit Orders to the Auction Agent as a

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Beneficial Owner or a Potential Beneficial Owner and therefore participate in an Auction as an Existing Holder or Potential Holder on behalf of both itself and its customers. Any Order placed with the Auction Agent by a Broker-Dealer as or on behalf of a Beneficial Owner or a Potential Beneficial Owner will be treated in the same manner as an Order placed with a Broker-Dealer by a Beneficial Owner or a Potential Beneficial Owner. Similarly, any failure by a Broker-Dealer to submit to the Auction Agent an Order in respect of any AMPS held by it or its customers who are Beneficial Owners will be treated in the same manner as a Beneficial Owner's failure to submit to its Broker-Dealer an Order in respect of AMPS held by it, as described in the next paragraph. Inasmuch as a Broker-Dealer participates in an Auction as an Existing Holder or a

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Potential Holder only to represent the interests of a Beneficial Owner or Potential Beneficial Owner, whether it be its customers or itself, all discussion herein relating to the consequences of an Auction for Existing Holders and Potential Holders also applies to the underlying beneficial ownership interests represented thereby. For information concerning the priority given to different types of Orders placed by Existing Holders, see "Submission of Orders by Broker-Dealers to Auction Agent." Each purchase or sale in an Auction will be settled on the Business Day next succeeding the Auction Date at a price per share equal to \$25,000. See "Notification of Results; Settlement" below.

If one or more Orders covering in the aggregate all of the outstanding shares of AMPS held by a Beneficial Owner are not submitted to the Auction Agent prior to the Submission Deadline, either because a Broker-Dealer failed to contact such Beneficial Owner or otherwise, the Auction Agent shall deem a Hold Order (in the case of an Auction relating to a Dividend Period which is not a Special Dividend Period of more than 28 days) and a Sell Order (in the case of an Auction relating to a Special Dividend Period of more than 28 days) to have been submitted on behalf of such Beneficial Owner covering the number of outstanding shares of AMPS held by such Beneficial Owner and not subject to Orders submitted to the Auction Agent.

If all of the outstanding shares of AMPS are subject to Submitted Hold Orders, the Dividend Period next succeeding the Auction automatically shall be the same length as the immediately preceding Dividend Period, and the Applicable Rate for the next Dividend Period for all shares of AMPS of such series will be 60% of the Reference Rate on the date of the applicable Auction (or 90% of such rate if the Fund has provided notification to the Auction Agent prior to the Auction establishing the Applicable Rate for any dividend that net capital gain or other taxable income will be included in such dividend on shares of AMPS).

For the purposes of an Auction, shares of AMPS for which the Fund shall have given notice of redemption and deposited moneys therefor with the Auction Agent in trust or segregated in an account at the Fund's custodian bank for the benefit of holders of AMPS to be redeemed and for payment to the Auction Agent, as set forth under "Description of AMPS -- Redemption" in the statement of additional information, will not be considered as outstanding and will not be included in such Auction. Pursuant to the Articles Supplementary of the Fund, the Fund will be prohibited from reissuing and its affiliates (other than Merrill Lynch) will be prohibited from transferring (other than to the Fund) any shares of AMPS they may acquire. Neither the Fund nor any affiliate of the Fund may submit an Order in any Auction, except that an affiliate of the Fund that is a Broker-Dealer (i.e., Merrill Lynch) may submit an Order.

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Submission of Orders by Broker-Dealers to Auction Agent. Prior to 1:00 p.m., Eastern time, on each Auction Date, or such other time on the Auction Date as may be specified by the Auction Agent (the "Submission Deadline"), each Broker-Dealer will submit to the Auction Agent in writing or through a mutually acceptable electronic means all Orders obtained by it for the Auction to be conducted on such Auction Date, designating itself (unless otherwise permitted by the Fund) as the Existing Holder or Potential Holder in respect of the shares of AMPS subject to such Orders. Any Order submitted by a Beneficial Owner or a Potential Beneficial Owner to its Broker-Dealer, or by a Broker-Dealer to the Auction Agent, prior to the Submission Deadline on any Auction Date, shall be irrevocable.

If the rate per annum specified in any Bid contains more than three figures to the right of the decimal point, the Auction Agent will round such rate per annum up to the next highest one-thousandth (.001) of 1%.

If one or more Orders of an Existing Holder are submitted to the Auction Agent and such Orders cover in the aggregate more than the number of outstanding shares of AMPS held by such Existing Holder, such Orders will be considered valid in the following order of priority:

(a) any Hold Order will be considered valid up to and including the number of outstanding shares of AMPS held by such Existing Holder, provided that if more than one Hold Order is submitted by such Existing Holder and the number of shares of AMPS subject to such Hold Orders exceeds the number of outstanding shares of AMPS held by such Existing Holder, the number of shares of AMPS subject to each of such Hold Orders will be reduced pro rata so that such Hold Orders, in the aggregate, will cover exactly the number of outstanding shares of AMPS held by such Existing Holder;

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(b) any Bids will be considered valid, in the ascending order of their respective rates per annum if more than one Bid is submitted by such Existing Holder, up to and including the excess of the number of outstanding shares of AMPS held by such Existing Holder over the number of outstanding shares of AMPS subject to any Hold Order referred to in clause (a) above (and if more than one Bid submitted by such Existing Holder specifies the same rate per annum and together they cover more than the remaining number of shares that can be the subject of valid Bids after application of clause (a) above and of the foregoing portion of this clause (b) to any Bid or Bids specifying a lower rate or rates per annum, the number of shares subject to each of such Bids will be reduced pro rata so that such Bids, in the aggregate, cover exactly such remaining number of outstanding shares); and the number of outstanding shares, if any, subject to Bids not valid under this clause (b) shall be treated as the subject of a Bid by a Potential Holder; and

(c) any Sell Order will be considered valid up to and including the excess of the number of outstanding shares of AMPS held by such Existing Holder over the sum of the number of shares of AMPS subject to Hold Orders referred to in clause (a) above and the number of shares of AMPS subject to valid Bids by such Existing Holder referred to in clause (b) above; provided that, if more than one Sell Order is submitted by any Existing Holder and the number of shares of AMPS subject to such Sell Orders is greater than such excess, the number of shares of AMPS subject to each of such Sell Orders will be reduced pro rata so that such Sell

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Orders, in the aggregate, will cover exactly the number of shares of AMPS equal to such excess.

If more than one Bid of any Potential Holder is submitted in any Auction, each Bid submitted in such Auction will be considered a separate Bid with the rate per annum and number of shares of AMPS therein specified.

Determination of Sufficient Clearing Bids, Winning Bid Rate and Applicable Rate. Not earlier than the Submission Deadline for each Auction, the Auction Agent will assemble all Orders submitted or deemed submitted to it by the Broker-Dealers (each such "Hold Order," "Bid" or "Sell Order" as submitted or deemed submitted by a Broker-Dealer hereinafter being referred to as a "Submitted Hold Order," a "Submitted Bid" or a "Submitted Sell Order," as the case may be, or as a "Submitted Order") and will determine the excess of the number of outstanding shares of AMPS over the number of outstanding shares of AMPS subject to Submitted Hold Orders (such excess being referred to as the "Available AMPS") and whether Sufficient Clearing Bids have been made in such Auction. Sufficient Clearing Bids will have been made if the number of outstanding shares of AMPS that are the subject of Submitted Bids of Potential Holders with rates per annum not higher than the Maximum Applicable Rate equals or exceeds the number of outstanding shares that are the subject of Submitted Sell Orders (including the number of shares subject to Bids of Existing Holders specifying rates per annum higher than the Maximum Applicable Rate).

If Sufficient Clearing Bids have been made, the Auction Agent will determine the lowest rate per annum specified in the Submitted Bids (the "Winning Bid Rate") which would result in the number of shares subject to Submitted Bids specifying such rate per annum or a lower rate per annum being at least equal to the Available AMPS. If Sufficient Clearing Bids have been made, the Winning Bid Rate will be the Applicable Rate for the next Dividend Period for all shares of AMPS then outstanding.

If Sufficient Clearing Bids have not been made (other than because all outstanding shares of AMPS are the subject of Submitted Hold Orders), the Dividend Period next following the Auction automatically will be a 7-Day Dividend Period in the case of the Series C AMPS, and the Applicable Rate for such Dividend Period will be equal to the Maximum Applicable Rate.

If Sufficient Clearing Bids have not been made, Beneficial Owners that have Submitted Sell Orders will not be able to sell in the Auction all, and may not be able to sell any, shares of AMPS subject to such Submitted Sell Orders. See "Acceptance and Rejection of Submitted Bids and Submitted Sell Orders and Allocation of Shares." Thus, under some circumstances, Beneficial Owners may not have liquidity of investment.

Acceptance and Rejection of Submitted Bids and Submitted Sell Orders and Allocation of Shares. Based on the determinations described under "Determination of Sufficient Clearing Bids, Winning Bid Rate and Applicable Rate" and subject to the discretion of the Auction Agent to round as described below, Submitted Bids and Submitted Sell Orders will be accepted or rejected in the order of priority set forth in the Auction Procedures with the result

that Existing Holders and Potential Holders of AMPS will sell, continue to hold and/or purchase shares of AMPS as set forth below. Existing Holders that submit or are deemed to have submitted Hold Orders will continue to hold the shares of AMPS subject to such Hold Orders.

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If Sufficient Clearing Bids have been made:

(a) each Existing Holder that placed a Submitted Bid specifying a rate per annum higher than the Winning Bid Rate or a Submitted Sell Order will sell the outstanding shares of AMPS subject to such Submitted Bid or Submitted Sell Order;

(b) each Existing Holder that placed a Submitted Bid specifying a rate per annum lower than the Winning Bid Rate will continue to hold the outstanding shares of AMPS subject to such Submitted Bid;

(c) each Potential Holder that placed a Submitted Bid specifying a rate per annum lower than the Winning Bid Rate will purchase the number of shares of AMPS subject to such Submitted Bid;

(d) each Existing Holder that placed a Submitted Bid specifying a rate per annum equal to the Winning Bid Rate will continue to hold the outstanding shares of AMPS subject to such Submitted Bids, unless the number of outstanding shares of AMPS subject to all such Submitted Bids of Existing Holders is greater than the excess of the Available AMPS over the number of shares of AMPS accounted for in clauses (b) and (c) above, in which event each Existing Holder with such a Submitted Bid will sell a number of outstanding shares of AMPS determined on a pro rata basis based on the number of outstanding shares of AMPS subject to all such Submitted Bids of such Existing Holders; and

(e) each Potential Holder that placed a Submitted Bid specifying a rate per annum equal to the Winning Bid Rate will purchase any Available AMPS not accounted for in clause (b), (c) or (d) above on a pro rata basis based on the shares of AMPS subject to all such Submitted Bids of Potential Holders.

If Sufficient Clearing Bids have not been made (other than because all outstanding shares of AMPS are the subject of Submitted Hold Orders):

(a) each Existing Holder that placed a Submitted Bid specifying a rate per annum equal to or lower than the Maximum Applicable Rate will continue to hold the outstanding shares of AMPS subject to such Submitted Bid;

(b) each Potential Holder that placed a Submitted Bid specifying a rate per annum equal to or lower than the Maximum Applicable Rate will purchase the number of shares of AMPS subject to such Submitted Bid; and

(c) each Existing Holder that placed a Submitted Bid specifying a rate per annum higher than the Maximum Applicable Rate or a Submitted Sell Order will sell a number of outstanding shares of AMPS determined on a pro rata basis based on the outstanding shares of AMPS subject to all such Submitted Bids and Submitted Sell Orders.

If as a result of the Auction Procedures described above any Existing Holder would be entitled or required to sell, or any Potential Holder would be entitled or required to purchase, a fraction of a share of AMPS, the Auction Agent, in such manner as, in its sole discretion, it shall determine, will round up or down the number of shares of AMPS being sold or purchased on such Auction Date so that each share sold or purchased by each Existing Holder or Potential Holder will be a whole share of AMPS. If any Potential Holder would be entitled or required to purchase less than a whole share of AMPS, the Auction Agent, in such manner as, in its sole discretion, it shall determine, will allocate shares of AMPS for purchase among Potential Holders so that only whole shares of AMPS are purchased by any such Potential Holder, even if such

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allocation results in one or more of such Potential Holders not purchasing any shares of AMPS.

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Notification of Results; Settlement. The Auction Agent will advise each Broker-Dealer who submitted a Bid or Sell Order in an Auction whether such Bid or Sell Order was accepted or rejected in whole or in part and of the Applicable Rate for the next Dividend Period for the related shares of AMPS by telephone at approximately 3:00 P.M., Eastern time, on the Auction Date for such Auction. Each such Broker-Dealer that submitted an Order for the account of a customer then will advise such customer whether such Bid or Sell Order was accepted or rejected, will confirm purchases and sales with each customer purchasing or selling shares of AMPS as a result of the Auction and will advise each customer purchasing or selling shares of AMPS to give instructions to its Agent Member of the Securities Depository to pay the purchase price against delivery of such shares or to deliver such shares against payment therefor as appropriate. If a customer selling shares of AMPS as a result of an Auction shall fail to instruct its Agent Member to deliver such shares, the Broker-Dealer that submitted such customer's Bid or Sell Order will instruct such Agent Member to deliver such shares against payment therefor. Each Broker-Dealer that submitted a Hold Order in an Auction on behalf of a customer also will advise such customer of the Applicable Rate for the next Dividend Period for the AMPS. The Auction Agent will record each transfer of shares of AMPS on the record book of Existing Holders to be maintained by the Auction Agent. In accordance with the Securities Depository's normal procedures, on the day after each Auction Date, the transactions described above will be executed through the Securities Depository, and the accounts of the respective Agent Members at the Securities Depository will be debited and credited as necessary to effect the purchases and sales of shares of AMPS as determined in such Auction. Purchasers will make payment through their Agent Members in same-day funds to the Securities Depository against delivery through their Agent Members; the Securities Depository will make payment in accordance with its normal procedures, which now provide for payment in same-day funds. If the procedures of the Securities Depository applicable to AMPS shall be changed to provide for payment in next-day funds, then purchasers may be required to make payment in next day funds. If any Existing Holder selling shares of AMPS in an Auction fails to deliver such shares, the Broker-Dealer of any person that was to have purchased shares of AMPS in such Auction may deliver to such person a number of whole shares of AMPS that is less than the number of shares that otherwise was to be purchased by such person. In such event, the number of shares of AMPS to be so delivered will be determined by such Broker-Dealer. Delivery of such lesser number of shares will constitute good delivery. Each Broker-Dealer Agreement also will provide that neither the Fund nor the Auction Agent will have responsibility or liability with respect to the failure of a Potential Beneficial Owner, Beneficial Owner or their respective Agent Members to deliver shares of AMPS or to pay for shares of AMPS purchased or sold pursuant to an Auction or otherwise.

### Broker-Dealers

General. The Broker-Dealer Agreements provide that a Broker-Dealer may submit Orders in Auctions for its own account, unless the Fund notifies all Broker-Dealers that they no longer may do so; provided that Broker-Dealers may continue to submit Hold Orders and Sell Orders. If a Broker-Dealer submits an Order for its own account in any Auction of the AMPS, it may have knowledge of Orders placed through it in that Auction and therefore have an advantage over other Bidders, but such Broker-Dealer would not have knowledge of Orders

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submitted by other Broker-Dealers in that Auction.

Merrill Lynch has advised the Fund that they and certain Broker-Dealers and other participants in the auction rate securities markets, including both taxable and tax exempt markets, have received a letter from the Commission requesting that each of them voluntarily conduct an investigation regarding their respective practices and procedures in those markets. Merrill Lynch is cooperating fully with the Commission in this process. No assurance can be given as to whether the results of this process will affect the market for the AMPS or the Auctions.

Fees. The Auction Agent after each Auction will pay a service charge from funds provided by the Fund to each Broker-Dealer on the basis of the purchase price of shares of AMPS placed by such Broker-Dealer at such Auction. The service charge (i) for any 7-Day Dividend Period shall be payable at the annual rate of 0.25% of the purchase price of the shares of AMPS placed by such Broker-Dealer in any such Auction and (ii) for any Special Dividend Period shall be determined by mutual consent of the Fund and any such Broker-Dealer or Broker-Dealers and shall be based upon a selling concession that would be applicable to an underwriting of fixed or variable rate preferred shares with a similar final maturity or variable rate dividend period, respectively, at the commencement of the Dividend Period with respect to such Auction. For the purposes of the preceding sentence, shares of AMPS will be placed by a Broker-Dealer if such shares were (i) the subject of Hold Orders deemed to have been made by Beneficial Owners that were acquired by such Beneficial Owners through such Broker-Dealer or (ii) the subject of

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the following Orders submitted by such Broker-Dealer: (A) a Submitted Bid of a Beneficial Owner that resulted in such Beneficial Owner continuing to hold such shares as a result of the Auction, (B) a Submitted Bid of a Potential Beneficial Owner that resulted in such Potential Beneficial Owner purchasing such shares as a result of the Auction or (C) a Submitted Hold Order.

Secondary Trading Market. The Broker-Dealers intend to maintain a secondary trading market in the AMPS outside of Auctions; however, they have no obligation to do so and there can be no assurance that a secondary market for the AMPS will develop or, if it does develop, that it will provide holders with a liquid trading market (i.e., trading will depend on the presence of willing buyers and sellers and the trading price is subject to variables to be determined at the time of the trade by the Broker-Dealers). The AMPS will not be registered on any stock exchange or on any automated quotation system. An increase in the level of interest rates, particularly during any Long Term Dividend Period, likely will have an adverse effect on the secondary market price of the AMPS, and a selling stockholder may sell AMPS between Auctions at a price per share of less than \$25,000.

### RATING AGENCY GUIDELINES

Certain of the capitalized terms used herein not otherwise defined in this prospectus have the meaning provided in the Glossary at the back of this prospectus.

The Fund currently intends that, so long as shares of AMPS are outstanding and the AMPS are rated by Moody's and S&P, the composition of its portfolio will reflect guidelines established by Moody's and S&P in connection with the Fund's receipt of a rating for such shares on or prior to their Date of Original Issue of at least Aaa from Moody's and AAA from S&P. Moody's and



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S&P, which are NRSROs, issue ratings for various securities reflecting the perceived creditworthiness of such securities. The Board of Directors of the Fund, however, may determine that it is not in the best interest of the Fund to continue to comply with the guidelines of Moody's or S&P (described below). If the Fund voluntarily terminates compliance with Moody's or S&P guidelines, the Fund will no longer be required to maintain a Moody's Discounted Value or a S&P Discounted Value, as applicable, at least equal to the AMPS Basic Maintenance Amount. If the Fund voluntarily terminates compliance with Moody's or S&P guidelines, or both, at the time of termination, it must continue to be rated by at least one NRSRO.

The guidelines described below have been developed by Moody's and S&P in connection with issuances of asset-backed and similar securities, including debt obligations and variable rate preferred stock, generally on a case-by-case basis through discussions with the issuers of these securities. The guidelines are designed to ensure that assets underlying outstanding debt or preferred stock will be varied sufficiently and will be of sufficient quality and amount to justify investment-grade ratings. The guidelines do not have the force of law but have been adopted by the Fund in order to satisfy current requirements necessary for Moody's and S&P to issue the above-described ratings for shares of AMPS, which ratings generally are relied upon by institutional investors in purchasing such securities. The guidelines provide a set of tests for portfolio composition and asset coverage that supplement (and in some cases are more restrictive than) the applicable requirements under the 1940 Act. See "Description of AMPS -- Asset Maintenance" herein and in the statement of additional information.

The Fund intends to maintain a Discounted Value for its portfolio at least equal to the AMPS Basic Maintenance Amount. Moody's and S&P each has established separate guidelines for determining Discounted Value. To the extent any particular portfolio holding does not satisfy the applicable rating agency's guidelines, all or a portion of such holding's value will not be included in the calculation of Discounted Value (as defined by such rating agency). The Moody's and S&P guidelines do not impose any limitations on the percentage of Fund assets that may be invested in holdings not eligible for inclusion in the calculation of the Discounted Value of the Fund's portfolio.

Upon any failure to maintain the required Discounted Value, the Fund will seek to alter the composition of its portfolio to reattain a Discounted Value at least equal to the AMPS Basic Maintenance Amount on or prior to the AMPS Basic Maintenance Cure Date, thereby incurring additional transaction costs and possible losses and/or gains on dispositions of portfolio securities. To the extent any such failure is not cured in a timely manner, shares of AMPS will be subject to redemption. See "Description of AMPS -- Asset Maintenance" and "Description of AMPS -- Redemption" herein and in the statement of additional information.

The Fund may, but is not required to, adopt any modifications to these guidelines that hereafter may be established by Moody's or S&P. Failure to adopt any such modifications, however, may result in a change in the ratings described above or a withdrawal of ratings altogether. In addition, any rating agency providing a rating for the shares of AMPS, at any time, may change or withdraw any such rating. As set forth in the Articles Supplementary, the Board of Directors, without stockholder approval, may modify certain definitions or restrictions that have been adopted by the Fund pursuant to the rating agency guidelines, provided the Board of Directors has obtained written confirmation from Moody's and S&P that any such change would not impair the

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ratings then assigned by Moody's and S&P to the AMPS.

As described by Moody's and S&P, a preferred stock rating is an assessment of the capacity and willingness of an issuer to pay preferred stock obligations. The ratings on the AMPS are not recommendations to purchase, hold or sell shares of AMPS, inasmuch as the ratings do not comment as to market price or suitability for a particular investor, nor do the rating agency guidelines described above address the likelihood that a holder of shares of AMPS will be able to sell such shares in an Auction. The ratings are based on current information furnished to Moody's and S&P by the Fund and the Investment Adviser and information obtained from other sources. The ratings may be changed, suspended or withdrawn as a result of changes in, or the unavailability of, such information. The common stock has not been rated by a nationally recognized statistical rating organization.

For additional information concerning the Moody's and S&P ratings guidelines, see "Rating Agency Guidelines" in the statement of additional information.

### INVESTMENT ADVISORY AND MANAGEMENT ARRANGEMENTS

The Investment Adviser, which is owned and controlled by Merrill Lynch & Co. Inc. ("ML & Co."), a financial services holding company and the parent of Merrill Lynch, provides the Fund with investment advisory and administrative services. The Investment Adviser acts as the investment adviser to more than 100 registered investment companies and offers investment advisory services to individuals and institutional accounts. As of May 2004, the Investment Adviser and its affiliates, including Merrill Lynch Investment Managers, L.P. ("MLIM"), had a total of approximately \$491 billion in investment company and other portfolio assets under management, including approximately \$253 billion in fixed income assets. This amount includes assets managed by certain affiliates of the Investment Adviser. The Investment Adviser is a limited partnership, the partners of which are ML & Co. and Princeton Services. The principal business address of the Investment Adviser is 800 Scudders Mill Road, Plainsboro, New Jersey 08536.

The Investment Advisory Agreement provides that, subject to the supervision of the Fund's Board of Directors, the Investment Adviser is responsible for the actual management of the Fund's portfolio. The responsibility for making decisions to buy, sell or hold a particular security rests with the Investment Adviser, subject to review by the Board of Directors.

The portfolio manager primarily responsible for the Fund's day-to-day management is Theodore R. Jaeckel. Mr. Jaeckel has been a Director of MLIM since 1997. Mr. Jaeckel has been a portfolio manager with the Investment Adviser and MLIM since 1991 and has been the Fund's portfolio manager since 1998. The Fund's portfolio manager will consider analyses from various sources, make the necessary investment decisions, and place orders for transactions accordingly.

For its services, the Fund pays the Investment Adviser a monthly fee at the annual rate of 0.50% of the Fund's average weekly net assets ("average weekly net assets" means the average weekly value of the total assets of the Fund, including the proceeds from the issuance of preferred stock, minus the sum of (i) accrued liabilities of the Fund, (ii) any accrued and unpaid interest on outstanding borrowings and (iii) accumulated dividends on shares of preferred stock). For purposes of this calculation, average weekly net assets is determined at the end of each month on the basis of the average net assets of the Fund for each week during the month. The assets for each weekly period are determined by averaging the net assets at the last business day of a week with the net assets at the last business day of the prior week. The

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liquidation preference of any outstanding preferred stock (other than accumulated dividends) is not considered a liability in determining the Fund's average daily net assets.

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The Investment Advisory Agreement obligates the Investment Adviser to provide investment advisory services and to pay all compensation of and furnish office space for officers and employees of the Fund connected with investment and economic research, trading and investment management of the Fund, as well as the compensation of all Directors of the Fund who are affiliated persons of the Investment Adviser or any of its affiliates. The Fund pays all other expenses incurred in the operation of the Fund, including, among other things, expenses for legal and auditing services, taxes, costs of preparing, printing and mailing proxies, listing fees, stock certificates and stockholder reports, charges of the custodian and the transfer agent, dividend disbursing agent and registrar, Commission fees, fees and expenses of non-interested Directors, accounting and pricing costs, insurance, interest, brokerage costs, litigation and other extraordinary or non-recurring expenses, mailing and other expenses properly payable by the Fund. Certain accounting services are provided to the Fund by State Street Bank and Trust Company ("State Street") pursuant to an agreement between State Street and the Fund. The Fund will pay the costs of these services. In addition, the Fund will reimburse the Investment Adviser for certain additional accounting services.

### TAXES

To the extent derived from Municipal Bond interest income, dividends on the AMPS will be excludable from gross income for Federal income tax purposes in the hands of holders of such AMPS, subject to the possible application of the Federal alternative minimum tax and any state or local income taxes. Interest income from other investments may produce taxable dividends. The Fund is required to allocate net capital gain and other taxable income, if any, proportionately among the common stock and AMPS and Other AMPS in accordance with the current position of the IRS described under the heading "Taxes" in the statement of additional information. The Fund may notify the Auction Agent of the amount of any net capital gain or other anticipated taxable income to be included in any dividend on the AMPS prior to the Auction establishing the Applicable Dividend Rate for such dividend. The Auction Agent will in turn notify holders of the AMPS and prospective purchasers. The Fund also may include such income in a dividend on shares of AMPS without giving advance notice thereof if it increases the dividend by an additional amount calculated as if such income were a Retroactive Taxable Allocation and the additional amount were an Additional Dividend. See "The Auction -- Auction Procedures -- Auction Date; Advance Notice of Allocation of Taxable Income; Inclusion of Taxable Income in Dividends." The amount of taxable income allocable to AMPS will depend upon the amount of such income realized by the Fund and cannot be determined with certainty prior to the end of the Fund's fiscal year, but it is not generally expected to be significant.

To the extent distributions are derived from interest or gains on New Jersey Municipal Bonds, such distributions will be exempt from New Jersey personal income tax. In order to pass through tax-exempt interest for New Jersey personal income tax purposes, the Fund, among other requirements, must have not less than 80% of the aggregate principal amount of its investments invested in New Jersey Municipal Bonds at the close of each quarter of the tax year (the "80% Test"). For purposes of calculating whether the 80% Test is satisfied, financial options, futures, forward contracts and similar financial instruments relating to interest-bearing obligations are excluded from the

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principal amount of the Fund's investments. The Fund intends to comply with this requirement so as to enable it to pass through interest exempt from New Jersey personal income tax. In the event the Fund does not so comply, distributions by the Fund may be taxable to stockholders for New Jersey personal income tax purposes. However, regardless of whether the Fund meets the 80% Test, all distributions attributable to interest earned on Federal obligations will be exempt from New Jersey personal income tax. Interest on indebtedness incurred or continued to purchase or carry Fund shares is not deductible for New Jersey personal income tax purposes to the extent attributable to exempt-interest dividends.

Exempt-interest dividends and gains paid to a corporate stockholder will be subject to New Jersey corporation business (franchise) tax, and, if applicable, the New Jersey corporation income tax, and may also be subject to state taxes in states other than New Jersey. Accordingly, stockholders of the Fund, including, in particular, corporate stockholders that might be subject to the New Jersey corporation business (franchise) tax and, if applicable, the New Jersey corporation income tax, should consult their tax advisers with respect to the application of such taxes to an investment in the Fund, to the receipt of Fund dividends and as to their New Jersey tax situation in general.

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Under present New Jersey law, a RIC, such as the Fund, pays a flat tax of \$500 per year. The Fund might be subject to the New Jersey corporation business (franchise) tax for any taxable year in which it does not qualify as a RIC.

On February 21, 1997, the Tax Court of New Jersey ruled against the Director of the Division of Taxation holding against the New Jersey requirement that fund investors pay state taxes on interest their funds earned from U.S. government securities if the 80% Test was not met. As a result of the court decision, the State of New Jersey could be forced to pay substantial amounts in tax refunds to state residents who are fund investors. At this time, the effect of this litigation cannot be evaluated.

Stockholders subject to income taxation by states other than New Jersey will realize a lower after-tax rate of return than New Jersey stockholders because the dividends distributed by the Fund generally will not be exempt, to any significant degree, from income taxation by such other states.

If the Fund makes a Retroactive Taxable Allocation, it will pay Additional Dividends to holders of AMPS who are subject to the Retroactive Taxable Allocation. See "Description of AMPS - Dividends - Additional Dividends." The Federal income tax consequences of Additional Dividends under existing law are uncertain. The Fund intends to treat a holder as receiving a dividend distribution in the amount of any Additional Dividend only as and when such Additional Dividend is paid. An Additional Dividend generally will be designated by the Fund as an exempt-interest dividend except as otherwise required by applicable law. However, the IRS may assert that all or part of an Additional Dividend is a taxable dividend either in the taxable year for which the Retroactive Taxable Allocation is made or in the taxable year in which the Additional Dividend is paid.

Generally within 60 days after the end of the Fund's taxable year, the Fund will tell you the amount of exempt-interest dividends and capital gain dividends you received during that year. Capital gain dividends are taxable as long-term capital gains to you regardless of how long you have held your shares.

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The Fund will only purchase a Municipal Bond or Non-Municipal Tax Exempt Security if it is accompanied by an opinion of counsel to the issuer, which is delivered on the date of issuance of the security, that the interest paid on such security is excludable from gross income for Federal income tax purposes and, if applicable, is exempt from New Jersey personal income tax. To the extent that the dividends distributed by the Fund are from interest income that is excludable from gross income for Federal income tax purposes, they are exempt from Federal income tax. There is a possibility that events occurring after the date of issuance of a security, or after a Fund's acquisition of a security, may result in a determination that the interest on that security is, in fact, includable in gross income for Federal income tax purposes retroactively to its date of issue. Such a determination may cause a portion of prior distributions received by stockholders, including holders of AMPS, to be taxable to those stockholders in the year of receipt. The Fund will not pay an Additional Dividend to a holder of AMPS under these circumstances.

Because the Fund may from time to time invest a substantial portion of its portfolio in Municipal Bonds bearing income that could increase an AMPS holder's tax liability under the Federal alternative minimum tax, the Fund would not ordinarily be a suitable investment for investors who are subject to the alternative minimum tax.

If at any time when AMPS are outstanding the Fund does not meet the asset coverage requirements of the 1940 Act, the Fund will be required to suspend distributions to holders of common stock until the asset coverage is restored. See "Description of AMPS -- Dividends -- Restrictions on Dividends and Other Payments" herein and in the statement of additional information. This may prevent the Fund from meeting certain distribution requirements for qualification as a RIC. Upon any failure to meet the asset coverage requirements of the 1940 Act, the Fund, in its sole discretion, may, and under certain circumstances will be required to, redeem AMPS in order to maintain or restore the requisite asset coverage and avoid the adverse consequences to the Fund and its stockholders of failing to qualify as a RIC. See "Description of AMPS -- Redemption" herein and in the statement of additional information. There can be no assurance, however, that any such action would achieve such objectives.

By law, your dividends and redemption proceeds will be subject to a withholding tax if you have not provided a tax identification number or social security number or if the number you have provided is incorrect.

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This section summarizes some of the consequences of an investment in the Fund under current Federal income tax laws. It is not a substitute for personal tax advice. Stockholders are urged to consult their tax advisers regarding the applicability of any state or local taxes and with specific questions regarding Federal taxes.

### DESCRIPTION OF CAPITAL STOCK

The Fund is authorized to issue 200,000,000 shares of capital stock, par value \$.10 per share, all of which shares initially were classified as common stock. The Board of Directors is authorized, however, to classify and reclassify any unissued shares of capital stock into one or more additional or other classes or series as may be established from time to time by setting or changing in any one or more respects the designations, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends,

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qualifications or terms or conditions of redemption of such shares of stock and pursuant to such classification or reclassification to increase or decrease the number of authorized shares of any existing class or series. In this regard, the Board of Directors previously reclassified 3,900 shares of unissued common stock as Other AMPS and has reclassified 1,100 shares of unissued common stock as AMPS, which are being offered hereby. See "Description of AMPS" herein and in the statement of additional information.

The following table shows the amount of (i) capital stock authorized, (ii) capital stock held by the Fund for its own account and (iii) capital stock outstanding for each class of authorized securities of the Fund as of July 7, 2004.

Title of Class	Amount Authorized	Amount Held By Fund For Its Own Account
-----	-----	-----
Common Stock.....	199,996,100	- 0 -
Auction Market Preferred Stock		
Series A AMPS.....	2,400	- 0 -
Series B AMPS.....	1,500	- 0 -

The Fund will send unaudited reports at least semi-annually and audited annual financial statements to all of its stockholders.

### Common Stock

Holders of common stock are entitled to share equally in dividends declared by the Board of Directors payable to holders of common stock and in the net assets of the Fund available for distribution to holders of common stock after payment of the preferential amounts payable to holders of any outstanding preferred stock. Neither holders of common stock nor holders of preferred stock have pre-emptive or conversion rights and shares of common stock are not redeemable. The outstanding shares of common stock are fully paid and non-assessable.

Holders of common stock are entitled to one vote for each share held and will vote with the holders of any outstanding shares of AMPS or other preferred stock, including the Other AMPS, on each matter submitted to a vote of holders of common stock, except as described under "Description of AMPS -- Voting Rights" herein and in the statement of additional information.

Stockholders are entitled to one vote for each share held. The shares of common stock, AMPS, Other AMPS and any other preferred stock do not have cumulative voting rights, which means that the holders of more than 50% of the shares of common stock, AMPS, Other AMPS and any other preferred stock voting for the election of Directors can elect all of the Directors standing for election by such holders, and, in such event, the holders of the remaining shares of common stock, AMPS, Other AMPS and any other preferred stock will not be able to elect any of such Directors.

So long as any shares of the Fund's preferred stock are outstanding, including the AMPS and Other AMPS, holders of common stock will not be entitled to receive any net income of or other distributions from the Fund unless all accumulated dividends on preferred stock have been paid, and unless asset coverage (as defined in the 1940 Act) with respect to preferred stock would be at least 200% after giving effect to such distributions. See "Description of AMPS -- Dividends -- Restrictions on Dividends and Other Payments" herein and in the statement of additional information."

#### Preferred Stock

The Fund has issued an aggregate of 3,900 shares of Other AMPS. Under the Articles Supplementary for the AMPS, the Fund is authorized to issue an aggregate of 1,100 shares of AMPS. The terms of the shares of Other AMPS are substantially the same as the terms of the shares of AMPS. See "Description of AMPS." Under the 1940 Act, the Fund is permitted to have outstanding more than one series of preferred stock as long as no single series has priority over another series as to the distribution of assets of the Fund or the payment of dividends. Neither holders of common stock nor holders of preferred stock have pre-emptive rights to purchase any shares of AMPS, Other AMPS or any other preferred stock that might be issued. It is anticipated that the net asset value per share of the AMPS will equal its original purchase price per share plus accumulated dividends per share.

#### Certain Provisions of the Charter and By-laws

The Fund's Charter includes provisions that could have the effect of limiting the ability of other entities or persons to acquire control of the Fund or to change the composition of its Board of Directors and could have the effect of depriving common stockholders of an opportunity to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund. A Director may be removed from office with or without cause but only by vote of the holders of at least 66 2/3% of the shares entitled to vote in an election to fill that directorship. A director elected by all of the holders of capital stock may be removed only by action of such holders, and a director elected by the holders of AMPS and any other preferred stock may be removed only by action of AMPS and any other preferred stock.

In addition, the Charter requires the favorable vote of the holders of at least 66 2/3% of the Fund's shares to approve, adopt or authorize the following:

- o a merger or consolidation or statutory share exchange of the Fund with any other corporation;
- o a sale of all or substantially all of the Fund's assets (other than in the regular course of the Fund's investment activities); or
- o a liquidation or dissolution of the Fund;

unless such action has been approved, adopted or authorized by the affirmative vote of at least two-thirds of the total number of Directors fixed in accordance with the By-laws, in which case the affirmative vote of a majority of the Fund's shares of capital stock is required. The approval, adoption or authorization of the foregoing also requires the favorable vote of a majority of the Fund's outstanding shares of preferred stock, including the AMPS and Other AMPS, then entitled to be voted, voting as a separate class.

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In addition, conversion of the Fund to an open-end investment company would require an amendment to the Fund's Charter. The amendment would have to be declared advisable by the Board of Directors prior to its submission to stockholders. Such an amendment would require the favorable vote of the holders of at least 66 2/3% of the Fund's outstanding shares of capital stock (including the AMPS, Other AMPS and any other preferred stock) entitled to be voted on the matter, voting as a single class (or a majority of such shares if the amendment was previously approved, adopted or authorized by two-thirds of the total number of Directors fixed in accordance with the By-laws), and the affirmative vote of a majority of outstanding shares (as defined in the 1940 Act) of preferred stock of the Fund (including the AMPS and Other AMPS), voting as a separate class. Such a vote also would satisfy a separate requirement in the 1940 Act that the change be approved by the stockholders. Stockholders of an open-end investment company may require the company to redeem their shares of common stock at any time (except in

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certain circumstances as authorized by or under the 1940 Act) at their net asset value, less such redemption charge, if any, as might be in effect at the time of a redemption. If the Fund is converted to an open-end investment company, it could be required to liquidate portfolio securities to meet requests for redemption, and the common stock would no longer be listed on a stock exchange. Conversion to an open-end investment company would also require redemption of all outstanding shares of preferred stock (including the AMPS and Other AMPS) and would require changes in certain of the Fund's investment policies and restrictions, such as those relating to the issuance of senior securities, the borrowing of money and the purchase of illiquid securities.

The Charter and By-laws provide that the Board of Directors has the power to make, alter or repeal any of the By-laws (except for any By-law specified not to be amended or repealed by the Board), subject to the requirements of the 1940 Act. Neither this provision of the Charter, nor any of the foregoing provisions of the Charter requiring the affirmative vote of 66 2/3% of shares of capital stock of the Fund, can be amended or repealed except by the vote of such required number of shares.

The Board of Directors has determined that the 66 2/3% voting requirements described above, which are greater than the minimum requirements under Maryland law or the 1940 Act, are in the best interests of stockholders generally. Reference should be made to the Charter on file with the Commission for the full text of these provisions.

### CUSTODIAN

The Fund's securities and cash are held under a custodian agreement with The Bank of New York, 101 Barclay Street, New York, New York 10286.

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### UNDERWRITING

Merrill Lynch, Pierce, Fenner & Smith Incorporated (the "Underwriter")



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has agreed, subject to the terms and conditions contained in a purchase agreement with the Fund and the Investment Adviser, to purchase from the Fund all of the shares of AMPS offered hereby. The Underwriter has agreed to purchase all such shares if any are purchased.

The Fund and the Investment Adviser have agreed to indemnify the Underwriter against certain liabilities, including liabilities under the Securities Act of 1933, as amended, or to contribute to payments the Underwriter may be required to make in respect of those liabilities.

The Underwriter is offering the shares, subject to prior sale, when, as and if issued to and accepted by them, subject to approval of legal matters by its counsel, including the validity of the shares, and other conditions contained in the purchase agreement, such as the receipt by the Underwriter of officer's certificates and legal opinions. The Underwriter reserves the right to withdraw, cancel or modify offers to the public and to reject orders in whole or in part.

### Commissions and Discounts

The Underwriter has advised the Fund that it proposes initially to offer the shares of AMPS to the public at the initial public offering price on the cover page of this prospectus and to dealers at that price less a concession not in excess of \$137.50 per share. There is a sales charge or underwriting discount of \$250 per share, which is equal to 1% of the initial public offering price per share. After the initial public offering, the public offering price and concession may be changed. Investors must pay for any AMPS purchased in the offering on or before , 2004.

The expenses of the offering, excluding underwriting discount, are estimated at \$135,000 and are payable by the Fund.

### Other Relationships

Merrill Lynch acts in Auctions as a Broker-Dealer as set forth under "The Auction -- General -- Broker-Dealer Agreements" and will be entitled to fees for services as a Broker-Dealer as set forth under "The Auction -- Broker-Dealers." Merrill Lynch also may provide information to be used in ascertaining the Reference Rate.

The Fund also anticipates that Merrill Lynch may from time to time act as a broker in connection with the execution of its portfolio transactions. See "Portfolio Transactions" in the statement of additional information. Merrill Lynch is an affiliate of the Investment Adviser. See "Investment Restrictions" and "Portfolio Transactions" in the statement of additional information.

The address of the Underwriter is 4 World Financial Center, New York, New York 10080.

### TRANSFER AGENT, DIVIDEND DISBURSING AGENT AND REGISTRAR

The transfer agent, dividend disbursing agent and registrar for the Fund's shares of common stock, AMPS and Other AMPS is The Bank of New York, 101 Barclay Street, New York, New York 10286.

### ACCOUNTING SERVICES PROVIDER

State Street Bank and Trust Company, 500 College Road East, Princeton, New Jersey 08540, provides certain accounting services for the Fund.

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### LEGAL OPINIONS

Certain legal matters in connection with the AMPS offered hereby are passed on for the Fund and the Underwriter by Sidley Austin Brown & Wood LLP, New York, New York 10019.

### INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM AND EXPERTS

\_\_\_\_\_ is the Fund's independent registered public accounting firm. The audited financial statements of the Fund and certain of the information appearing under the caption "Financial Highlights" included in this prospectus have been audited by \_\_\_\_\_ for the periods indicated in its report with respect thereto, and are included in reliance upon such report and upon the authority of such firm as experts in accounting and auditing. \_\_\_\_\_ has an office at \_\_\_\_\_.

### ADDITIONAL INFORMATION

The Fund is subject to the informational requirements of the Securities Exchange Act of 1934 and the 1940 Act and in accordance therewith is required to file reports, proxy statements and other information with the Commission. Any such reports and other information, including the Fund's Code of Ethics, can be inspected and copied at the public reference facilities of the Commission at Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549. Information on the operation of such public reference facilities may be obtained by calling the Commission at 1-202-942-8090. Copies of such materials can be obtained from the public reference section of the Commission by writing at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates, or by electronic request at [publicinfo@sec.gov](mailto:publicinfo@sec.gov). The Commission maintains a Web site at <http://www.sec.gov> containing reports and information statements and other information regarding registrants, including the Fund, that file electronically with the Commission. Reports, proxy statements and other information concerning the Fund can also be inspected at the offices of the New York Stock Exchange.

Additional information regarding the Fund is contained in the Registration Statement on Form N-2, including amendments, exhibits and schedules thereto, relating to such shares filed by the Fund with the Commission in Washington, D.C. This prospectus does not contain all of the information set forth in the Registration Statement, including any amendments, exhibits and schedules thereto. For further information with respect to the Fund and the shares offered hereby, reference is made to the Registration Statement. Statements contained in this prospectus as to the contents of any contract or other document referred to are not necessarily complete and in each instance reference is made to the copy of such contract or other document filed as an exhibit to the Registration Statement, each such statement being qualified in all respects by such reference. A copy of the Registration Statement may be inspected without charge at the Commission's principal office in Washington, D.C., and copies of all or any part thereof may be obtained from the Commission upon the payment of certain fees prescribed by the Commission.

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GLOSSARY

"Additional Dividend" has the meaning set forth on page [26] of this prospectus.

"Agent Member" means the member of the Securities Depository that will act on behalf of a Beneficial Owner of one or more shares of AMPS or on behalf of a Potential Beneficial Owner.

"AMPS" means the Auction Market Preferred Stock, Series C, with a par value of \$.10 per share and a liquidation preference of \$25,000 per share plus an amount equal to accumulated but unpaid dividends thereon (whether or not earned or declared) of the Fund.

"AMPS Basic Maintenance Amount" has the meaning set forth on page [27] of this prospectus.

"AMPS Basic Maintenance Cure Date" has the meaning set forth on page [27] of this prospectus.

"AMPS Basic Maintenance Report" has the meaning set forth on page [10] of the statement of additional information.

"Anticipation Notes" shall mean the following New Jersey Municipal Bonds: revenue anticipation notes, tax anticipation notes, tax and revenue anticipation notes, grant anticipation notes and bond anticipation notes.

"Applicable Percentage" has the meaning set forth on page [31] of this prospectus.

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"Applicable Rate" means the rate per annum at which cash dividends are payable on shares of AMPS for any Dividend Period.

"Applicable Spread" has the meaning set forth on page [31] of this prospectus.

"Articles Supplementary" means the Articles Supplementary of the Fund specifying the powers, preferences and rights of the shares of the AMPS.

"Auction" means a periodic operation of the Auction Procedures.

"Auction Agent" means The Bank of New York unless and until another commercial bank, trust company or other financial institution appointed by a resolution of the Board of Directors of the Fund or a duly authorized committee thereof enters into an agreement with the Fund to follow the Auction Procedures for the purpose of determining the Applicable Rate and to act as transfer agent, registrar, dividend disbursing agent and redemption agent for the AMPS.

"Auction Agent Agreement" means the agreement entered into between the Fund and the Auction Agent which provides, among other things, that the Auction Agent will follow the Auction Procedures for the purpose of determining the Applicable Rate.

"Auction Date" has the meaning set forth on page [30] of this prospectus.

"Auction Procedures" means the procedures for conducting Auctions set forth in Appendix D to the statement of additional information.

"Available AMPS" has the meaning set forth on page [33] of this prospectus.

"Beneficial Owner" means a customer of a Broker-Dealer who is listed on the records of that Broker-Dealer (or if applicable, the Auction Agent) as a holder of shares of AMPS or a Broker-Dealer that holds AMPS for its own account.

"Bid" has the meaning set forth on page [33] of this prospectus.

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"Bidder" has the meaning set forth on page [31] of this prospectus.

"Board of Directors" or "Board" means the Board of Directors of the Fund.

"Broker-Dealer" means any broker-dealer, or other entity permitted by law to perform the functions required of a Broker-Dealer in the Auction Procedures, that has been selected by the Fund and has entered into a Broker-Dealer Agreement with the Auction Agent that remains effective.

"Broker-Dealer Agreement" means an agreement entered into between the Auction Agent and a Broker-Dealer, including Merrill Lynch, Pierce, Fenner & Smith Incorporated, pursuant to which such Broker-Dealer agrees to follow the Auction Procedures.

"Business Day" means a day on which the New York Stock Exchange is open for trading and which is not a Saturday, Sunday or other day on which banks in The City of New York are authorized or obligated by law to close.

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"Cede" means Cede & Co., the nominee of DTC, and in whose name the shares of AMPS initially will be registered.

"Charter" means the Articles of Incorporation, as amended and supplemented (including the Articles Supplementary and the Other AMPS Articles Supplementary), of the Fund.

"Code" means the Internal Revenue Code of 1986, as amended.

"Common stock" means the common stock, par value \$.10 per share, of the Fund.

"Date of Original Issue" means, with respect to each share of AMPS, the date on which such share first is issued by the Fund.

"Deposit Securities" means cash and Municipal Bonds rated at least A2 (having a remaining maturity of 12 months or less), P-1, VMIG-1 or MIG-1 by Moody's or A (having a remaining maturity of 12 months or less), A-1+ or SP-1+ by S&P or A (having a remaining maturity of 12 months or less) or F-1+ by Fitch.

"Discount Factor" means a Moody's Discount Factor or an S&P Discount Factor, as the case may be.

"Discounted Value" means (i) with respect to an S&P Eligible Asset, the quotient of the fair market value thereof divided by the applicable S&P Discount Factor and (ii) with respect to a Moody's Eligible Asset, the lower of par and the quotient of the fair market value thereof divided by the applicable Moody's Discount Factor.

"Dividend Payment Date" has the meaning set forth on page [25] of this prospectus.

"Dividend Period" has the meaning set forth on page [25] of this prospectus.

"DTC" means The Depository Trust Company.

"Eligible Assets" means Moody's Eligible Assets or S&P Eligible Assets, as the case may be.

"Existing Holder" means a Broker-Dealer or any such other person as may be permitted by the Fund that is listed as the holder of record of shares of AMPS in the records of the Auction Agent.

"Fitch" means Fitch Ratings or its successors.

"Forward Commitment" has the meaning set forth on page [20] of the statement of additional information.

"Fund" means MuniYield New Jersey Fund, Inc., a Maryland corporation that is the issuer of the AMPS.

"High Yield Municipal Bonds" means (a) with respect to Moody's (1) New Jersey Municipal Bonds and Municipal Bonds rated Ba1 to B3 by Moody's, (2) New Jersey Municipal Bonds and Municipal Bonds not rated by Moody's, but rated BB+ to B- by S&P or Fitch, and (3) New Jersey Municipal Bonds and Municipal Bonds

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not explicitly rated by Moody's, S&P or Fitch, but rated at least the equivalent of B3 internally by the Investment Adviser, provided that Moody's reviews and achieves sufficient comfort with the Investment Adviser's internal credit rating processes, and (b) with respect to S&P (1) New Jersey Municipal Bonds not rated by S&P but rated equivalent to BBB+ or lower by another NRSRO and (2) New Jersey Municipal Bonds rated BB+ or lower by S&P.

"Hold Order" has the meaning set forth on page [30] of this prospectus.

"Initial Dividend Payment Date" means the first Dividend Payment Date for the Series C AMPS.

"Initial Dividend Period" means the period from and including the Date of Original Issue to but excluding the Initial Dividend Payment Date for the Series C AMPS.

"Initial Margin" means the amount of cash or securities deposited with a broker as a margin payment at the time of purchase or sale of a financial futures contract.

"Inverse Floaters" means trust certificates or other instruments evidencing interests in one or more New Jersey Municipal Bonds or Municipal Bonds that qualify as (i) S&P Eligible Assets the interest rates on which are adjusted at short term intervals on a basis that is inverse to the simultaneous readjustment of the interest rates on corresponding floating rate trust certificates or other instruments issued by the same issuer, provided that the ratio of the aggregate dollar amount of floating rate instruments to inverse floating rate instruments issued by the same issuer does not exceed one to one at their time of original issuance unless the floating rate instrument has only one reset remaining until maturity or (ii) Moody's Eligible Assets the interest rates on which are adjusted at short term intervals on a basis that is inverse to the simultaneous readjustment of the interest rates on corresponding floating rate trust certificates or other instruments issued by the same issuer, provided that (a) such Inverse Floaters are rated by Moody's with the Investment Adviser having the capability to collapse (or relink) within seven days as a liquidity enhancement measure, and (b) the issuer of such Inverse Floaters employs a leverage factor (i.e., the ratio of underlying capital appreciation bonds or other instruments to residual long-term derivative instruments) of not more than 2:1.

"Investment Adviser" means Fund Asset Management, L.P.

"IRS" means the United States Internal Revenue Service.  
Century Partners, LP. The shares being offered by Hua-Mei 21<sup>st</sup> Century Partners, LP represent 30,651 shares issuable upon exercise of \$1.50 warrants and 35,499 shares issuable upon exercise of \$2.07 warrants.

<sup>4</sup>For purposes of determining the percentage of outstanding after completion of the offering, we are assuming that all of the 2,250,000 shares of common stock covered by this prospectus have been issued and are outstanding. The total number of shares which would be owned beneficially by Barron Partners after the offering if the 4.9% limitation were not applicable is 5,032,530, representing the shares of common stock issuable upon conversion of the series A preferred stock and the warrants, which would represent beneficial ownership of 18.7% of our common stock.

Since neither EOS Holdings nor Hua-Mei 21<sup>st</sup> Century Partners, LP owns a significant percentage of the stock, the 4.9% limitation only applies to Barron Partners. The 4.9% limitation relates to the percentage beneficial ownership that Barron Partners may own at any one time. The 4.9% limitation does not preclude serial exercises and sales. If

Barron Partners exercises warrants to the extent of the 4.9% limitation, Barron Partners may sell those shares and exercise the warrants or convert shares of series A preferred stock to bring its beneficial ownership to 4.9%.

Pursuant to the securities purchase agreement, 2,833,333 shares of series A preferred stock, which are convertible into 944,445 shares of common stock, and 944,445 shares of common stock which are owned by our chief executive officer, Xiqun Yu, are held in escrow. If our pre-tax income for 2007 is less than \$0.19941 per share, on a fully-diluted basis, all or a portion of the shares of series A preferred stock will be delivered to the investors and all or a portion of the shares placed in escrow with Mr. Yu will be returned to us and cancelled. None of the escrow shares are treated as being beneficially owned by any of the selling stockholders either prior to or upon completion of the offering. The following table sets forth the maximum number of the shares of series A preferred stock which may be transferred to each of the selling stockholders.

Name	Maximum Number of Shares
Barron Partners, LP	2,645,833
Eos Holdings	104,167
Hua-Mei 21 <sup>st</sup> Century Partners, LP	83,333
Total	2,833,333

The shares being offered by the selling stockholders represent the shares of common stock issuable upon exercise of warrants that were issued upon conversion of the notes that were issued in the May 2007 private placement. See “Selling Stockholders - May 2007 Private Placement” for information relating to the shares of common stock issuable to the selling stockholders. We are not registering any shares of common stock issuable upon conversion of any of the shares of preferred stock which may be delivered to the selling stockholders pursuant to the escrow agreement or any shares which have been issued or may be issued pursuant to the liquidated damages provisions discussed in “Selling Stockholders - May 2007 Private Placement.”

Except as expressly provided in the certificate of designation relating to the series A preferred stock or the warrants, no person may convert shares of series A preferred stock or exercise warrants to the extent that such conversion or exercise would result in beneficial ownership by that person and its affiliates of more than 4.9% of the then outstanding number of shares of common stock on such date. Beneficial ownership is determined in accordance with Section 13(d) of the Securities Exchange Act of 1934, as amended, and Regulation 13d-3 thereunder. This provision, which cannot be modified, limits the ability of the holders of the series A preferred stock to convert their shares of series A preferred stock and exercise their warrants. This limitation applies separately to each of these selling stockholders and applies to shares owned by the selling stockholders at any one time. Upon disposition of the shares issuable upon conversion of the series A preferred stock and exercise of the warrants, the selling stockholders would be able to exercise or convert additional securities. As the number of outstanding shares of common stock increases, whether upon conversion of the series A preferred stock or exercise of warrants or for any other reason, the number of shares which could be issued under this limitation will increase. In the event that any holder of notes or the warrants issued in the May 2007 private placement transfers its or his notes or warrants, the transferee, if it is not an affiliate of the transferor, would be subject to a separate 4.9% limitation.

Although this prospectus does not cover shares of common stock issuable upon conversion of the series A preferred stock, the selling stockholders, who hold shares of series A preferred stock which are convertible into an aggregate of 3,063,063 shares of common stock, will be able to sell such shares of common stock pursuant to Rule 144 based on an amendment to the rule which permits stockholders who are not affiliates of an issuer to sell such stock without restriction after the shares have been held for six months. Since the holding period for these shares of common stock commenced in May 2007, the selling stockholders, as holders of the series A preferred stock, will be able to convert the series A preferred stock, subject to the 4.9% limitation, and sell the underlying common stock as soon as the amended Rule 144 becomes effective. The amendment to Rule 144 was announced in November 2007 and will become effective 60 days after the amended rule is published in the Federal Register.

None of the selling stockholders is a member, affiliate or associate of any broker-dealer. None of the selling stockholders has, or within the past three years has had, any position, office or material relationship with us or any of our predecessors or affiliates.

### **May 2007 Private Placement**

On May 8, and May 31 2007, we sold, pursuant to a securities purchase agreement, as amended, 3% convertible subordinated notes in the aggregate principal amount of \$3,400,000 to three investors. In October 2007, the notes were automatically converted into an aggregate of (i) 9,189,189 shares of our series A preferred stock, which are convertible into an aggregate of 3,063,063 shares of our common stock, subject to adjustment, (ii) five-year common stock purchase warrants to purchase 735,632 shares of common stock at \$1.50 per share, 2,833,333 shares of common



stock at \$2.07 per share, 681,034 shares of common stock at \$2.40 per share and 264,367 shares of common stock at \$3.00 per share.

The following table sets forth the investment made by each investor, which is the same as the principal amount of the note issued to each investor, the number of shares of preferred stock issued to the investor upon conversion of the notes, the number of shares of common stock are issuable upon conversion of the series A preferred stock, and the number of shares of common stock issuable upon exercise of each set of warrants:

Name	Investment	Preferred Stock	Common Stock	\$1.50 Warrants	\$2.07 Warrants	\$2.40 Warrants	\$3.00 Warrants
Barron Partners, LP	\$ 3,175,000	8,581,081	2,860,360	666,667	2,645,833	656,250	239,583
Eos Holdings	125,000	337,838	112,613	38,314	104,167	13,769	13,769
Hua-Mei 21 <sup>st</sup> Century Partners, LP	100,000	270,270	90,090	30,651	83,333	11,015	11,015
Total	\$ 3,400,000	9,189,189	3,063,063	735,632	2,833,333	681,034	264,367

The notes provided for interest at 3% per annum. However, upon the conversion of the notes, we issued the stock and warrants based on the principal amount of the notes, and we did not make any adjustment for the interest.

The warrants have a term of five years, and expire in May 2012. The warrants provide a cashless exercise feature; however, the holders of the warrants may not make a cashless exercise during the twelve months following the date of the initial issuance and thereafter only if the underlying shares are covered by an effective registration statement.

The warrants provide that the exercise price of the warrants may be reduced by up to 50% if our pre-tax income per share of common stock, on a fully-diluted basis, is less than \$0.19941. Pre tax-income is defined as income before income taxes determined in accordance with generally United States generally accepted accounting principles (“GAAP”) plus (a) any charges relating to the transaction contemplated by the purchase agreement and the registration rights agreement, minus (b) the amount, if any, by which all non-recurring losses or expenses exceed all non-recurring items or income or gain. Pre-tax income shall not be adjusted if all non-recurring items of income or gain exceed all non-recurring losses or expenses. Items shall be deemed to be non-recurring only if they qualify as non-recurring pursuant to GAAP. For determining pre-tax income per share, all shares which are outstanding or which may be issuable upon exercise or conversion of options, warrants and other convertible securities are deemed to be outstanding, regardless of whether the shares would be counted for purposes of computing diluted earnings per shares under GAAP. An adjustment in the warrant exercise price does not affect the number of shares issuable upon exercise of the warrants. The following table sets forth the exercise price of the warrants if our pre-tax income is 20% below the threshold (a “20% shortfall”) and 50% or more below the threshold (a “50% shortfall”):

	\$1.50 Warrant Exercise Price	\$2.07 Warrant Exercise Price	\$2.40 Warrant Exercise Price	\$3.00 Warrant Exercise Price
Unadjusted	\$ 1.50	\$ 2.07	\$ 2.40	\$ 3.00
20% shortfall	\$ 1.20	\$ 1.656	\$ 1.92	\$ 2.40
50% shortfall	\$ 0.75	\$ 1.035	\$ 1.20	\$ 1.50

The warrants also give us the right to call the warrants for \$.01 per share of common stock issuable upon exercise of the warrants if the trading price per share of the common stock is not less than the greater of (a) \$4.14 or 200% of the exercise price for the \$2.07 warrants, (b) \$4.14 or 276% of the exercise price for the \$1.50 warrants; (c) \$4.14 or 172.5% of the exercise price for the \$2.40 warrants, and (d) \$5.25 or 175% of the exercise price for the \$1.00 warrants on each trading day in the 20 trading days ending on the date prior to the date on which the warrants are called for redemption provided that the trading volume on each day in the computation period is at least 1,000 shares.

In order for us to exercise the right of redemption, a registration statement covering the sale of the underlying shares must be current and effective. In the event that, at any time subsequent to the date on which the warrants are called for redemption, the shares of common stock underlying the warrants are not subject to a current and effective registration statement, our right to call the warrants for redemption shall terminate with respect to all warrants that have not then been exercised or converted prior to that date.

The securities purchase agreement, the certificate of designation for the series A preferred stock and the warrants provide that those securities may not be exercised or converted if such conversion or exercise would result in the

holder and its affiliates having beneficial ownership of more than 4.9% of our outstanding common stock. Beneficial ownership is determined in accordance with Section 13(d) of the Securities Exchange Act of 1934, as amended, and Rule 13d-3 thereunder. This limitation may not be waived.

Pursuant to the purchase agreement, in addition to the foregoing:

- We amended our articles of incorporation to provide for a class of preferred stock and we created the series A preferred stock.
- We placed 944,445 shares of common stock and Mr. Xiqun Yu, our chief executive officer and principal stockholder, placed in escrow 944,445 shares of common stock. We are to deliver to the escrow agent a certificate for 2,833,333 shares of series A preferred stock, upon receipt of which the escrow agent is to return to us for cancellation the 944,445 shares of common stock that we placed in escrow.
- If our pre-tax income for 2007 is less than \$0.19941 per share, on a fully-diluted basis, the percentage shortfall shall be determined by dividing the amount of the shortfall by the target number. If the percentage shortfall is equal to or greater than 33 1/3%, then the 944,445 shares of common stock (or the 2,833,333 shares of series A preferred stock after the exchange of the common stock for the series A preferred stock as described above) shall be delivered to the investors and the 944,445 shares of common stock placed in escrow by Mr. Yu shall be delivered to us for cancellation.

If the percentage shortfall is less than 33 1/3%, the escrow agent shall:

- with respect to the shares placed in escrow by us, (i) deliver to the investors such number of shares of common stock as is determined by multiplying the percentage shortfall by 944,445 (or 2,833,333 shares of series A preferred stock after the exchange of the common stock for the preferred stock as described above), and (ii) deliver to the balance of such shares to us for cancellation, and
- with respect to the shares placed in escrow by Mr. Yu, (i) deliver to us such number of shares of common stock as is determined by multiplying the percentage shortfall by 944,445 shares, and we shall cancel such shares, and (ii) deliver to Mr. Yu the balance of the 944,445 shares that were not transferred to us.
- We agreed that, within 90 days after the closing, which was August 6, 2007, we would have appointed such number of independent directors that would result in a majority of our directors being independent directors and we would have an audit committee composed solely of at least three independent directors and a compensation committee would have a majority of independent directors. Thereafter, our failure to meet these requirements for a period of 60 days for an excused reason, as defined in the purchase agreement, or 75 days for a reason which is not an excused reason, would result in the imposition of liquidated damages which are payable in cash or additional shares of series A preferred stock. The liquidated damages are computed in an amount equal to 12% per annum of the principal amount of notes outstanding, up to a maximum of \$408,000, which is payable in cash or stock, at the election of the investors. Our failure to comply with these requirements resulted in our payment of liquidated damages through the payment of \$77,128 or the issuance of 208,456 shares of series A preferred stock as of October 15, 2007. The shares of series A preferred stock are convertible into 69,484 shares of common stock. The investors elected to take payment in stock, and we issued the shares in October 2007. The number of shares of series A preferred stock was based on the liquidation value of one share of series A preferred stock, which is \$.37 per share. The investors have waived their right to receive any additional liquidated damages through December 31, 2007 with respect to our failure to comply with these provisions. Pursuant to the securities purchase agreement, as amended, the shares of series A preferred stock are valued at the liquidation value, which is \$.37 per share of series A preferred stock. Since the market price for our common stock on October 15, 2007 was \$4.00 per share, the market value of the shares issued to the investors was approximately \$277,944. If we are required to issue any additional shares of series A preferred stock pursuant to the securities purchase agreement, we are to issue the shares at the \$.37 per share liquidation value.

We and the investors entered into a registration rights agreement pursuant to which we were required to have this registration statement filed with the SEC by July 7, 2007 and declared effective by the SEC not later than November 5, 2007. We filed the registration statement on September 13, 2007. In November 2007, we entered into an agreement with the investors pursuant to which the registration rights agreement was amended to eliminate the liquidated damages for failure to file this registration statement when required and waived any additional liquidated damages that would be due as a result of our failure to have the registration statement declared effective by December 31, 2007.

Liquidated damages under the registration rights agreement are payable through the issuance of additional shares of series A preferred stock at the rate of 2,130 shares of series A preferred stock for each day, based on the proposed registration of all of the underlying shares of common stock, with a maximum of 900,000 shares. However, since, pursuant to the SEC's rules relating to secondary offerings, we are not able to register all of the shares of common stock issuable upon conversion of the series A preferred stock or exercise of the warrants, the number of shares is reduced to a fraction of 2,130 shares, of which the numerator is the number of shares being registered (2,250,000) and the denominator is the number of shares issuable upon conversion of all of the series A preferred stock (3,063,063), which is 1,565 shares per day. If the registration statement of which this prospectus is a part is not declared effective by December 31, 2007 we will be required to issue 1,565 shares of series A preferred stock for each day subsequent to December 31, 2007 that the registration statement is not effective.

The investors have a right of first refusal on future financings.

- With certain limited exceptions, if we issue stock at a purchase price or warrants or convertible securities at an exercise or conversion price which is less than the conversion price of the series A preferred stock or the exercise price of the warrants, (a) the conversion price of the note and the series A preferred stock is reduced to the lower price and (b) exercise price will be reduced pursuant to a weighted average formula.
- We are restricted from issuing convertible debt or preferred stock or from having debt in an amount greater than twice our earnings before interest, taxes, depreciation and amortization.
- Our officers and directors agreed, with certain limited exceptions, not to publicly sell shares of common stock for 27 months or such earlier date as all of the convertible securities and warrants have been converted or exercised and the underlying shares of common stock have been sold.

We paid Barron Partners \$50,000 for its due diligence expenses.

In connection with the placement, we paid Brean Murray Carret & Co. a fee of \$60,000 and issued to Brean Murray a warrant to purchase 83,333 shares of common stock at \$2.25 per share, and paid cash fees of \$48,000 to Huang Jun and \$24,000 to Liu Zongbo.

The proceeds from the sale of the notes, after brokerage fees and closing costs was used to pay the principal and interest on bridge notes issued in September 2006 in the amount of \$1,364,578 and for working capital. The warrants to purchase shares of common stock which were issued in connection with the bridge notes (of which there are currently 382,503 outstanding), were modified so that the warrants will terminate on September 29, 2010 and have an exercise price of \$1.50 per share. The warrants give us the right to call the warrants for \$.01 per share after September 29, 2008 if the average closing sales price of our common stock exceeds \$4.14 per share during any period of 30 consecutive trading days. It was also agreed that there will be no piggy-back rights regarding the warrants in connection with the registration statement to be filed by us in connection with the notes issued pursuant to the purchase agreement and that the warrant holders will not exercise any demand registration rights until September 29, 2008; provided, however, the holders of the warrants shall not exercise any demand registration rights if (a) all of the underlying shares issuable upon exercise of such warrants may be sold pursuant to Rule 144(k) or any subsequent successor rule or (b) such warrants have not been called for redemption.

Table 1 sets forth the dollar value of any payment made by us, including the value of any payments made in stock, in connection with May 2007 private placement, to any selling stockholder or any affiliate of any selling stockholder or any person which we know to have a contractual relationship with any selling stockholder.

Table 1

Payee	Payment	Value of Payment	Purpose of Payment
Barron Partners	\$50,000	\$ 50,000	Due diligence payment made at closing
Brean Murray Carret & Co.	\$60,000 plus warrants to purchase 83,333 shares of common stock at \$2.25 per share	\$ 64,495	Investment banking fee
Huang Jun	\$48,000	\$ 48,000	Finders fee
Liu Zongbo	\$24,000	\$ 24,000	Finders fee
Barron Partners, Eos Holdings and Hua-Mei 21 <sup>st</sup> Century Partners	208,456 shares of series A preferred stock	\$ 77,128(1)	Liquidated damages for failing to have a majority of independent directors as of October 15, 2007
Barron Partners, Eos Holdings and Hua-Mei 21 <sup>st</sup> Century Partners	A maximum of 2,833,333 shares of series A preferred stock (potential) or 944,445 shares of common stock if the series A preferred stock is not exchanged for the common stock	\$ 4,476,666(2)	Maximum value of the 944,445 shares of common stock (or 2,833,333 shares of series A preferred stock upon the exchange) held in escrow if such shares are delivered to the investors as a result a shortfall of 33 1/3% or more from our targeted pre-tax income.

(1) The value of the series A preferred stock is based on the liquidation value of one share of series A preferred stock, which is \$.37 per share. The value of such shares, based on the closing price of one share of common stock on November 26, 2007, would have been \$329,360.

(2) The series A preferred stock is based on a price of \$1.58 per share since each shares of series A preferred stock is convertible into one-third share of common stock and the price of the common stock on November 26, 2007 was \$4.74.

We received total proceeds of \$3,400,000 from the sale of the notes. After deducting the due diligence payment of \$50,000 to Barron Partners and the investment banking and finders fees in the amount of \$132,000, the net cash proceeds were \$3,218,000.

The closing price of our common stock on November 26, 2007 was \$4.74 per share. If all of the 2,250,000 shares of common stock that the selling stockholders propose to sell pursuant to this prospectus were sold at that price, the selling stockholders would realize gross proceeds of approximately \$10.7 million. Table 2 shows the potential profit from the sale of those shares if the shares could be sold at that price:

Table 2

Gross proceeds	\$ 10,665,000
Exercise price of the warrants	4,238,190
Potential profit	\$ 6,426,810

In Table 2, no portion of the purchase price of the notes was allocated to the shares of common stock issuable upon exercise of the warrants.

Table 3 sets forth information relating to the total profit which the selling stockholders may realize from their sale of the shares of common stock issuable upon conversion of the series A preferred stock and exercise of the warrants, based on the market price of our common stock on November 26, 2007 of \$4.74 per share.

Table 3

	Shares of common stock issuable upon exercise or conversion of						
	Series A Preferred	\$1.50 warrants	\$2.07 warrants	\$2.40 warrants	\$3.00 warrants		Total
Issued at closing	3,063,063	735,632	2,833,333	681,034	264,367		7,577,429
Liquidated damages	69,484	0	0	0	0		69,484
Total	3,132,547	735,632	2,833,333	681,034	264,367		7,646,913
Cost	\$ 3,400,000	\$ 1,103,448	\$ 5,864,999	\$ 1,634,482	\$ 793,101	\$	\$ 12,796,030
Sales price at \$4.74	\$ 14,848,273	\$ 3,486,896	\$ 13,429,998	\$ 3,228,101	\$ 1,253,100	\$	\$ 36,246,368
Discount based on \$4.74 price	\$ 11,448,273	\$ 2,383,448	\$ 7,564,999	\$ 1,593,620	\$ 459,999	\$	\$ 23,450,338
Maximum adjustment if earnings target is not met	\$ 4,476,666	\$ 551,724	\$ 2,932,500	\$ 817,241	\$ 396,551	\$	\$ 9,174,681
Discount resulting from the foregoing adjustments	\$ 15,924,939	\$ 2,935,172	\$ 10,497,499	\$ 2,410,860	\$ 856,549	\$	\$ 32,625,019



In Table 3:

- The purchase price of the notes is being allocated to the shares issuable upon conversion of the series A preferred stock. The effective price per share for the shares issuable upon conversion of the shares of series A preferred stock is \$1.11 per share. There is no cost associated with the shares issued for liquidated damages.
- The number of shares issued as liquidated damages reflect those shares that were paid to the selling stockholders as of October 15, 2007, and is based on the assumption that the registration statement will be declared effective by December 31, 2007.
- The maximum adjustment if earnings target is not met reflects (a) the value of the common stock issuable upon conversion of the maximum number of shares of series A preferred stock which may be delivered to the selling stockholders from escrow and (b) the increase in the discount resulting from the maximum reduction in the exercise price of the warrants.
- The discount referred to in the table represents the potential profit to the selling stockholder based on the assumptions reflected in the table.

Table 4 sets forth information concerning the gross proceeds paid or payable to us, the net proceeds and the potential profit to the selling stockholders based on the closing price of our common stock on November 26, 2007 of \$4.74 per share, and the ratio of the potential profit to the net proceeds to us.

Table 4

1. Gross proceeds payable at closing	\$	3,400,000
2. Gross proceeds from exercise of all warrants at current exercise price		9,396,030
3. Total gross proceeds		12,796,030
4. Cash payments to selling stockholders, brokers' commissions, value of equity issued to brokers and potential issuance of series A preferred stock if earnings targets are not met, as shown in Table 1		4,735,794
5. Net proceeds to us (line 3 minus line 4)		8,060,236
6. Potential profit to selling stockholders based on issuance of the maximum number of shares of series A preferred stock and the maximum reduction in the exercise price of the warrants, as shown in Table 3		32,625,023
7. Ratio of potential profit to selling stockholders (line 6 to net proceeds to us (line 5)		405%

Table 5 sets forth information as to our outstanding shares and shares issued to the selling stockholders.

Table 5

Shares outstanding prior to conversion of any shares of series A preferred stock or warrants, exclusive of shares held by officers, directors and affiliates	6,725,497
Shares registered for resale by selling stockholders and their affiliates prior to the registration statement of which this prospectus is part	0
Shares sold by selling stockholders and their affiliates pursuant to a registration statement	0
Shares issued to selling stockholders and their affiliates upon conversion of series a preferred stock or warrants and held by them	0
Shares registered for selling stockholders for sale pursuant to this prospectus which have not been sold as of the date of this prospectus	2,250,000

The number of shares included in this registration statement represents 33.45% of the shares of common stock held by stockholders other than our officers, directors and affiliates.

The selling stockholders do not hold any option, warrants, notes or other convertible securities other than the securities described in this prospectus. Neither we nor our predecessor engaged in any securities transactions with any of the selling stockholders, their affiliates or any person which whom any selling stockholder has a contractual relationship regarding the sale by us of our securities to the selling stockholders. We have been advised by the selling stockholders that they do not have a short position in our common stock. Except as described in this prospectus, we do not have any agreements or understandings with any of the stockholders or any of their affiliates or any person known to us to have a contractual relationship with any of the selling stockholders.

### PLAN OF DISTRIBUTION

The selling stockholders and any of their pledgees, donees, assignees and successors-in-interest may, from time to time, sell any or all of their shares of common stock on any stock exchange, market or trading facility on which the shares are traded or in private transactions or by gift. These sales may be made at fixed or negotiated prices. The selling stockholders may use any one or more of the following methods when selling or otherwise transferring shares:

- ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;
- block trades in which a broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- sales to a broker-dealer as principal and the resale by the broker-dealer of the shares for its account;
- an exchange distribution in accordance with the rules of the applicable exchange;

privately negotiated transactions, including gifts;

covering short sales made after the date of this prospectus.

pursuant to an arrangement or agreement with a broker-dealer to sell a specified number of such shares at a stipulated price per share;

a combination of any such methods of sale; and

any other method of sale permitted pursuant to applicable law.

The selling stockholders may also sell shares under Rule 144 of the Securities Act of 1933, as amended (the “Securities Act”), if available, rather than pursuant to this prospectus. The selling stockholders shall have the sole and absolute discretion not to accept any purchase offer or make any sale of shares if it deems the purchase price to be unsatisfactory at any particular time.

The selling stockholders and their pledgees, donees, transferees or other successors in interest, may also sell the shares directly to market makers acting as principals and/or broker-dealers acting as agents for themselves or their customers. Such broker-dealers may receive compensation in the form of discounts, concessions or commissions from the selling stockholder and/or the purchasers of shares for whom such broker-dealers may act as agents or to whom they sell as principal or both, which compensation as to a particular broker-dealer might be in excess of customary commissions. Market makers and block purchasers purchasing the shares will do so for their own account and at their own risk. It is possible that the selling stockholder will attempt to sell shares of common stock in block transactions to market makers or other purchasers at a price per share which may be below the then existing market price. We cannot assure that all or any of the shares offered in this prospectus will be issued to, or sold by, the selling stockholders. The selling stockholders and any brokers, dealers or agents, upon effecting the sale of any of the shares offered in this prospectus, may be deemed to be an “underwriters” as that term is defined under the Securities Act in connection with such sales. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act.

We are required to pay all fees and expenses incident to the registration of the shares, including fees and disbursements of counsel to the selling stockholder, but excluding brokerage commissions or underwriter discounts.

The selling stockholders, alternatively, may sell all or any part of the shares offered in this prospectus through an underwriter. The selling stockholders have not entered into any agreement with a prospective underwriter and there is no assurance that any such agreement will be entered into. If the selling stockholders propose to sell shares to an underwriter, we will be required to amend this prospectus to reflect the terms of the underwritten offering.

The selling stockholders may pledge shares to brokers under the margin provisions of customer agreements. If the selling stockholders defaults on a margin loan, the broker may, from time to time, offer and sell the pledged shares. The selling stockholders and any other persons participating in the sale or distribution of the shares will be subject to applicable provisions of the Securities Exchange Act of 1934, as amended, and the rules and regulations under such Act, including, without limitation, Regulation M. These provisions may restrict certain activities of, and limit the timing of purchases and sales of any of the shares by, the selling stockholder or any other such person. In the event the selling stockholders is deemed an affiliated purchaser or distribution participant within the meaning of Regulation M, then the selling stockholder will not be permitted to engage in short sales of common stock. Furthermore, under Regulation M, persons engaged in a distribution of securities are prohibited from simultaneously engaging in market making and certain other activities with respect to such securities for a specified period of time prior to the commencement of such distributions, subject to specified exceptions or exemptions. In addition, if a short sale is deemed to be a stabilizing activity, then the selling stockholder will not be permitted to engage in a short sale of our

common stock. All of these limitations may affect the marketability of the shares.

If a selling stockholder notifies us that it has a material arrangement with a broker-dealer for the resale of the common stock, then we would be required to amend the registration statement of which this prospectus is a part, and file a prospectus supplement to describe the agreement between the selling stockholder and the broker-dealer.

## MARKET FOR COMMON STOCK AND STOCKHOLDER MATTERS

Our common stock is traded is the OTC Bulletin Board under the trading symbol CEUA. The table below presents the closing high and low closing bid prices for our common stock for each quarter from January 1, 2005 through September 30, 2007. These prices reflect inter-dealer prices, without retail markup, markdown, or commission, and may not represent actual transactions. We obtained the following information from the National Quotations Bureau, L.L.C., adjusted for the one-for-three reverse split.

	High Bid	Low Bid
<u>Year ended December 31, 2005</u>		
1 <sup>st</sup> Quarter	\$ 1.65	\$ 0.75
2 <sup>nd</sup> Quarter	0.90	0.51
3 <sup>rd</sup> Quarter	1.08	0.60
4 <sup>th</sup> Quarter	0.90	0.24
<u>Year ended December 31, 2006</u>		
1 <sup>st</sup> Quarter	2.58	0.30
2 <sup>nd</sup> Quarter	3.00	0.93
3 <sup>rd</sup> Quarter	1.32	0.66
4 <sup>th</sup> Quarter	2.43	0.84
<u>Year ended December 31, 2007</u>		
1 <sup>st</sup> Quarter	2.23	1.35
2 <sup>nd</sup> Quarter	1.95	0.78
3 <sup>rd</sup> Quarter	3.00	1.53

On December 19, 2007, the closing price of our common stock on the OTC Bulletin Board was \$5.42 per share.

We have not declared or paid any dividends on our common stock and presently does not expect to declare or pay any such dividends in the foreseeable future. Our securities purchase agreement relating to our May 2007 private placement prohibits us from paying dividends while the series A preferred stock is outstanding.

The stock transfer agent of the Company is Florida Atlantic Stock Transfer, Inc., 7130 Nob Hill Road, Tamarac, FL 33321.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion of the results of our operations and financial condition should be read in conjunction with our financial statements and the related notes, which appear elsewhere in this prospectus. The following discussion includes forward-looking statements. For a discussion of important factors that could cause actual results to differ from results discussed in the forward-looking statements, see "Forward Looking Statements."*

### Overview

Our principal business is the distribution of educational resources through the Internet. Our website, [www.edu-chn.com](http://www.edu-chn.com), is a comprehensive education network platform which is based on network video technology and large data sources of education resources. We have a data base comprised of such resources as test papers for secondary education courses as well as video on demand. Our data base includes more than 300,000 exams and test papers and courseware for secondary and elementary schools. We also offer, through our website, video on demand, which includes tutoring of past exam papers and exam techniques.

We also provide on-site teaching services in Harbin, where we have a 36,600 square foot training facility with 17 classrooms that can accommodate 1,200 students. These classes complement our on-line education services. The courses cover primarily the compulsory education curriculum of junior, middle and high school. We charge tuition for these classes.

We generate revenue from through our website by selling prepaid debit cards to our subscribers. These debit cards permit the subscriber to download materials from our website over a specified period, usually one year. We recognize revenue from the debit cards when the students use the debit cards to purchase our products. To the extent that the debit cards expire unused, we recognize the remaining balance of the debit card at that time. We also recognize revenue from our on-line education business through the sale of advertising on our website. We recognize revenue from our training centers classes ratably over the term of the course, and we recognize revenue from face-to-face tutorials to students in our training center and face-to-face information technology training courses.

The laws of China give the government broad power to fix and adjust prices. We need to obtain government approval in setting our prices for classroom coursework and tutorials, which affects our revenue in our training center business. Although the sale of educational material over the Internet is not presently subject to price controls, we cannot give you any assurance that they will not be subject to controls in the future. To the extent that we are subject to price control, our revenue, gross profit, gross margin and net income will be affected since the revenue we derive from our services will be limited and we may face no limitation on our costs. Further, if price controls affect both our revenue and our costs, our ability to be profitable and the extent of our profitability will be effectively subject to determination by the applicable Chinese regulatory authorities.

Because students who purchase our on-line programs purchase debit cards for the programs that they use and students who enroll in our training classes pay their tuition before starting classes, we do not have significant accounts receivable. At June 30, 2007, we had no accounts receivable.

Our prepaid expenses account for a significant portion of our current assets – approximately \$1,164,729, or 11% of current assets at September 30, 2007. Prepaid expenses are primarily comprised of advance payments made for services to teachers for online materials and video and prepaid rent. At September 30, 2007, prepayment of advertising for television advertising not yet aired was approximately \$424,093, prepayment to teachers for the development of educational materials was approximately \$424,943, prepayment of rent expense was \$150,077, and other prepaid expenses were approximately \$165,616. We amortize the prepayments to teachers over three months, which is the estimated life of the testing materials. The prepaid rent related to our Beijing office and dormitory rental for our training center. The prepayment to teachers decreases as the materials are delivered and the prepaid rent decreases ratably during the terms of the leases.

As a result both manner in which we recognize revenue and the manner that we expense the cost of our materials, there is a difference between our cash flow and both revenue and cost of revenue.

In our on-line education business, the principal component of cost of sales is the cost of obtaining new material to offer students as we increase the available material as well as depreciation related to computer equipment and software as well as direct labor cost. This business generates a relatively high gross margin, which was 81.3% for the nine months ended September 30, 2007. The gross margin is affected by the payments we have to make to the teachers for the materials. In our training center business, the principal components of cost of sales are faculty and the amortization of intangible assets. This business generates a lower gross margin than the on-line education business, which was 66.9% for the nine months ended September 30, 2007. The tuition that we charge our students at our training center is subject to government approval. As a result, we may not be able to pass on to our students any increases in costs we incur, including any increases in costs we incur, including increased costs of faculty. Our gross margin in the training center is also affected by the size of our classes.





Our on-line products and our training services are dependent upon the government's education policies. Any significant changes in curriculum or testing methods could render all or a significant portion of our library of test papers and our training center obsolete and we may have to devote substantial resources in adapting to the changes.

We have recently added a platform for training agencies and schools to offer their services, and we offer job search guidance and career planning courses to college students and graduates. This business is part of our on-line education business, since it is presently largely an Internet-based activity.

Because the purchase of both our on-line and our training center is made from discretionary funds, our business is dependent upon both the economy of China and the perception of students that they will benefit from improving their ability to perform well on standardized tests which are given before middle school, high school and university.

In December 2006, we acquired, for approximately \$1.0 million, all of the fixed assets and franchise rights of Harbin Nangang Compass Computer Training School ("Compass Training School"), which was engaged in the business of providing on-line education resources to computer vocational training school students. As a result of this acquisition, we became the exclusive partner of Beida Qingniao APTEC Software Engineering within Heilongjiang Province in China for vocational training. The acquisition included materials and resources to provide on-site education classes and patented course materials. Compass Training School currently has two principal education programs focused on network engineering and ACCP software engineering with 9 on-site classrooms and 9 multimedia/computer classrooms at two centers.

We own 70% of Beijing Hua Yu Hui Zhong Technology Development Co., Ltd, which was formed on September 30, 2006. At the time of its organization, we transferred a 30% interest in this subsidiary to The Vocational Education Guidance Center of China, a non-profit, quasi-government entity, for no consideration in order to enable us to work with the Guidance Center's network to expand our business. The value of this 30% interest, which is based on our cost, is treated as goodwill.

We are in the process of introducing new services aimed at the students who want to go to vocational school. These students include high school students who do not continue their education at universities and university graduates who are not able to find employment. The core business our vocation education will be in three main areas: vocation education enrollment, vocational certification, and career development for college graduates. We have collaborated with the China Vocation Education Society in setting up [www.360ve.com](http://www.360ve.com), which provides information regarding vocation training schools and vocation training both on-line and on-site.

### **Significant Accounting Estimates and Policies**

The discussion and analysis of our financial condition and results of operations is based upon our financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities. On an on-going basis, we evaluate our estimates including the allowance for doubtful accounts, the salability and recoverability of our products, income taxes and contingencies. We base our estimates on historical experience and on other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Property and equipment are evaluated for impairment whenever indicators of impairment exist. Accounting standards require that if an impairment indicator is present, we must assess whether the carrying amount of the asset is unrecoverable by estimating the sum of the future cash flows expected to result from the asset, undiscounted and without interest charges. If the recoverable amount is less than the carrying amount, an impairment charge must be recognized, based on the fair value of the asset.

Franchise rights, which we acquired from third parties, are amortized over the lives of the rights agreements, which is five years. We evaluate the carrying value of the franchise rights during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the intangible asset below its carrying amount. There were no impairments recorded during the year ended December 31, 2006.

In connection with the organization of our subsidiary, Beijing Hua Yu Hui Zhong Technology Development Co., we gave an unrelated governmental entity a 30% ownership in interest in the contributed capital of that subsidiary. This transfer of ownership is reflected as goodwill on our consolidated financial statements. At September 30, 2007, goodwill incurred in connection with this transaction was \$43,696. We evaluate the carrying value of goodwill during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. There were no impairment losses recorded for the year ended December 31, 2006.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes. This process involves estimating our current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent that we establish a valuation allowance or increase this allowance in a period, we must include a tax provision or reduce our tax benefit in the statements of operations. We use our judgment to determine our provision or benefit for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We believe, based on a number of factors including historical operating losses, that we will not realize the future benefits of a significant portion of our net deferred tax assets and we have accordingly provided a full valuation allowance against our deferred tax assets. However, various factors may cause those assumptions to change in the near term.

We cannot predict what future laws and regulations might be passed that could have a material effect on our results of operations. We assess the impact of significant changes in laws and regulations on a regular basis and update the assumptions and estimates used to prepare our financial statements when we deem it necessary.

We have determined the significant principles by considering accounting policies that involve the most complex or subjective decisions or assessments. Our most significant accounting policies are those related to revenue recognition and deferred revenue.

Revenue is recognized in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition, which states that revenue should be recognized when the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) the service has been rendered; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. We believe that these criteria are satisfied upon customers' download of prepaid study materials. Prepaid debit cards allow our subscribers to purchase a predetermined monetary amount of download materials posted on our website. Prepaid service contracts are amortized to income on a straight line basis over the length of the service contract. These service contracts allow the user to obtain materials for a designed period of time. At the time that the prepaid debit card is purchased, the receipt of cash is recorded as deferred revenue. Revenues are recognized in the month when services are actually rendered. Unused value relating to debit cards is recognized as

revenues when the prepaid debit card has expired. Revenue from advertising on our website is recognized when the advertisement is run. Since advertising customers are billed monthly, there are no unearned advertising revenues.

Prepaid expenses are primarily comprised of advance payments made for services to teachers for on-line materials and video and prepaid rent.

Deferred revenue includes subscriber prepayments and education fee prepayments. Subscriber prepayments represents deferred revenue for the purchase of debit cards used to pay for the on-line downloading of education materials, including testing booklets, supplemental materials and teaching video clips. We value the sales based on the actual occurrence of customer download. Therefore, the spare time between the purchase of debit cards and actual download is recorded under advances on accounts as deferred or unearned revenues. Once the download takes place, the amount is then transferred from advances on accounts to sales. Education fee prepayments represent tuition payments and payments for service contracts which are amortized over their respective terms.

We do not have any stock option or other equity-based incentive plans for our officers, directors or key employees. To the extent that we do adopt such plans in the future, such grants will be valued at the granting date and expensed over the applicable vesting period as required by Statement of Financial Accounting Standard No. 123(revised 2004), "Share-Based Payments."

### **New Accounting Pronouncements**

In July 2006, the FASB released FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), an interpretation of FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 clarifies the accounting and reporting for income taxes where interpretation of the law is uncertain. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken in income tax returns. FIN 48 is effective on January 1, 2007. This Statement has no current applicability to our financial statements. Management's adoption of this Statement did not have a material impact on our financial position, results of operations, or cash flows.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("SFAS No.157"). SFAS No. 157 addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under GAAP. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. We anticipate adopting this standard as of January 1, 2008. Management has not determined the effect, if any, the adoption of this statement will have on our financial condition or results of operations.

In September 2006, the FASB issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" ("SFAS No. 158"), an amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS No. 158 requires (a) recognition of the funded status (measured as the difference between the fair value of the plan assets and the benefit obligation) of a benefit plan as an asset or liability in the employer's statement of financial position, (b) measurement of the funded status as of the employer's fiscal year-end with limited exceptions, and (c) recognition of changes in the funded status in the year in which the changes occur through comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. The requirement to measure the plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. This Statement has no current applicability to our financial statements. Management adopted this Statement on January 1, 2007 and our adoption of SFAS No. 158 did not have a material impact to our financial position, results of operations, or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 ("SAB No. 108"). SAB No. 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB No. 108 requires companies to quantify misstatements using a balance sheet and income statement approach and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. When the effect of initial adoption is material, companies will record the effect as a cumulative effect adjustment to beginning of year retained earnings and disclose the nature and amount of each individual error being corrected in the cumulative adjustment. SAB No. 108 was effective beginning January 1, 2007. We do not believe SAB 108 will have a material impact on our results from operations or financial position.

In February 2007, the FASB issued Statement No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159). This statement permits companies to choose to measure many financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of SFAS 159 on its consolidated financial statements.

## Results of Operations

The following table sets forth information from our statements of operations for the nine months ended September 30, 2007 and 2006 and the years ended December 31, 2006 and 2005, in dollars and as a percentage of revenue:

	(Dollars in thousands)							
	Nine Months Ended September 30,				Year Ended December 31,			
	2007		2006		2006		2005	
<b>Revenues:</b>								
Online education	\$ 9,958	79.5%	\$ 4,436	76.5%	\$ 6,621	79.5%	\$ 2,424	77.9%
Training center	2,566	20.5%	1,363	23.5%	1,704	20.5%	689	22.1%
<b>Cost of sales</b>								
Online education	1,855	14.8%	1,236	21.3%	1,766	21.2%	727	23.4%
Training center	848	6.6%	656	11.3%	797	9.6%	290	9.3%
<b>Gross profit</b>								
Online education	8,102	64.7%	3,200	55.2%	4,854	58.3%	1,697	54.5%
Training center	1,717	13.7%	707	12.2%	907	10.9%	399	12.8%
<b>Operating expenses:</b>								
Selling expenses	3,412	27.2%	465	8.0%	1,404	16.9%	170	5.5%
Administrative	913	7.3%	184	3.2%	1,517	18.2%	113	3.6%
	341	2.7%	89	1.5%	124	1.5%	134	4.3%

Depreciation and Amortization								
Income from operations	5,153	41.1%	3,169	54.6%	2,716	32.6%	1,678	53.9%
Interest income (expense), net	(507)	(4.1)%	10	0.17%	135	1.6%	(2)	(0.1)%
Other income, net	299	2.4%	0	0.0%	0	0.0%	26	0.8%
Income before income taxes	4,944	39.5%	3,179	54.8%	2,581	31.0%	1,706	54.8%
Provision for income taxes	395	3.2%	0	0.0%	0	0.0%	2	0.1%
Income before minority interest	4,549	36.3%	3,179	54.8%	2,581	31.0%	1,703	54.7%
Net income	4,549	36.3%	3,179	54.8%	2,625	31.5%	1,703	54.7%

The following table sets forth information as to the gross margin for our two lines of business for the nine months ended September 30, 2007 and 2006 and the years ended December 31, 2006 and 2005.

	(Dollars in thousands)			
	Nine Months Ended September 30,		Year Ended December 31,	
	2007	2006	2006	2005
<b>On-line Education:</b>				
Revenue	\$ 9,958	\$ 4,436	\$ 6,621	\$ 2,424
Cost of sales	1,856	1,236	1,766	727
Gross profit	8,102	3,200	4,854	1,697
Gross margin	81.3%	72.1%	73.3%	70.0%
<b>Training center</b>				
Revenue	\$ 2,566	\$ 1,363	\$ 1,704	\$ 689
Cost of sales	848	656	797	290
Gross profit	1,718	707	907	399
Gross margin	66.9%	51.9%	53.2%	57.9%

#### **Nine Months Ended September 30, 2007 and 2006**

Revenues for the nine months ended September 30, 2007 increased by approximately \$6.7 million, or 116%, in 2007 to approximately \$12.5 million as compared to approximately \$5.8 million for the nine months ended September 30, 2006. The increase in revenue reflected increases of approximately \$5.5 million from our on-line education line of business and approximately \$1.2 million for our training center business line. Advertising income is included in our online education revenue. Advertising income increased as the result of the increased awareness of our website, which resulted in more viewers coming to our website, thus enabling us to increase our advertising income to \$1.6 million, an increase of \$392,388. During 2006 and 2007, we added several new programs for vocational studies and certification programs, which provided new sources of income for our online education business line.

Our overall cost of sales increased by approximately \$813,000 to \$2.7 million for the nine months ended September 30, 2007, as compared to approximately \$1.9 million from the comparative prior year period. The increase in cost of sales reflects a \$620,000 increase in our cost of sales for our online education business line in 2007 while the remaining \$193,000 of the increase was from our training center business line. The online training business line gross margin increased to 81.3% for the nine months ended September 30, 2007 from 72.1% from the comparative prior year period due to the fact that online education costs are somewhat fixed and margins increase with volume. The online education business line gross margin for the nine months ended September 30, 2007 also reflects an increase in advertising revenue which has no substantial cost associated with it. Our training center business line gross margin increased to 66.9% for the nine months ended September 30, 2007 from 51.9% from the comparative prior year period due to decreased payments to lecturers.

Selling expenses increased by approximately \$2.9 million, or 634%, to approximately \$3.4 million for the nine months ended September 30, 2007 from approximately \$465,000 from the comparative prior year period. Until the middle of 2006, we did not have a significant selling effort, which is reflected in the modest selling expenses for the nine months ended September 30, 2006. Our selling expenses include agency fees associated with increased sales of our debit cards.

Administrative expenses increased by \$729,047, or 396%, to \$913,073 for the nine months ended September 30, 2007 as compared to \$184,026 from the comparative prior year period. The increase is due primarily to an increase in salaries due to the overall growth of our business and increases in travel and telephone expenses.

Depreciation and amortization increased by \$252,052, or 282%, to \$341,301 for the nine months ended September 30, 2007, as compared to \$89,249 in the nine months ended September 30, 2006. This increase was due to depreciation and amortization associated with increases in fixed assets and amortization of intangible assets.

Interest expense was \$542,173 for the nine months ended September 30, 2007, which related to the bridge loan which was made in September 2006. There was no interest expense or debt in the comparative prior year period. Interest income for the nine months ended September 30, 2007 was \$34,339 as compared to September 30, 2006 which was \$10,049, which related to earnings on cash balances.



Under current Chinese tax law, a wholly foreign owned enterprise has a 100% tax holiday for the first two years and a 50% tax holiday for the following three years. Since we became a wholly foreign owned enterprise in 2005, we benefited from a 100% tax holiday for 2005 and 2006 and, under the present law, we will benefit from a 50% tax holiday for 2007, 2008 and 2009. As a result, we paid no income tax in the nine months ended September 30, 2006, and our income tax for the nine months ended September 30, 2007 reflects income tax at 50% of the tax rate of 15%, which is subject to changes in tax rates implemented in 2007 that go into effect commencing January 1, 2008. These changes will have the effect of increasing the enterprise tax rate by 2% per year until it reaches an effective tax rate of 25%.

As a result of the foregoing, we had net income of \$4,548,666, or \$0.24 per share (basic and diluted), for the nine months ended September 30, 2007, as compared with net income of \$3,179,070, or \$0.16 per share (basic and diluted), for the comparative prior year period.

#### **Years Ended December 31, 2006 and December 31, 2005**

Revenues for the year ended December 31, 2006 increased by approximately \$5.2 million, or 167%, to approximately \$8.3 million from the year ended December 31, 2005. The increase in revenue reflected increases of approximately \$4.2 million from the online education division and approximately \$1.0 million for the training center. Advertising revenue is included in our online education revenue. Advertising revenue increased as the result of the increased awareness of our website, which resulted in more viewers coming to our website, thus enabling us to increase our advertising revenue to \$1.7 million, an increase of \$1.4 million. During 2006, we added several new programs for vocational studies and certification programs, which provides new source of income for our online education business during the second half of 2006.

Our overall cost of sales increased by approximately \$1.5 million to approximately \$2.5 million in 2006, as compared to approximately \$1.0 million in 2005. The increase in cost of sales reflects a approximately \$1.0 million increase in our cost of sales for the online education division for 2006 while the remaining \$500,000 of the increase was from the training center division. The online training division gross margin increased to 73.3% in 2006 from 70.0% in 2005 because online costs are somewhat fixed and margins increase with volume and the advertising revenue has no substantial cost associated with it. The training center division gross margin decreased to 53.2% in 2006 from 57.9% in 2005 due to decreased payments to lecturers.

Selling expenses increased by approximately \$1.2 million, or 726%, to approximately \$1.4 million in 2006 from approximately \$170,000 in 2005. Until the middle of 2006, we did not have a significant selling effort, which is reflected in the modest selling expenses in 2005. Our selling expenses include agency fees associated with increased sales of our debit cards.

Administrative expenses increased by approximately \$1.4 million, to approximately \$1.5 million, from \$113,000 in 2005. The increase is due primarily to an increase in salaries due to the overall growth of our business and increases in travel and telephone expenses.

Depreciation and amortization decreased by \$10,000, from \$134,000 to \$124,000.

Interest expense was \$147,000 in 2006, resulting from the bridge loan which was made in September 2006. We had modest interest income and no debt or interest in 2005.

Under current Chinese tax law, a wholly foreign owned enterprise has a 100% tax holiday for the first two years and a 50% tax holiday for the following three years. Since we became a wholly foreign owned enterprise in 2005, we benefited from a 100% tax holiday for 2005 and 2006. As a result, we paid no income tax in 2006 or 2005.

As a result of the foregoing, we had net income of approximately \$2.6 million, or \$.05 per share (basic and diluted), for 2006, as compared with net income of approximately \$1.7 million, or \$.03 per share (basic and diluted), for 2005.

### **Liquidity and Capital Resources**

Our current assets primarily consist of cash and prepaid expenses. We do not have inventory or accounts receivable, and our other receivables are not significant. Our prepaid expenses are primarily advance payments made to teachers for on-line materials and prepaid rent.

At September 30, 2007, we had cash and cash equivalents of approximately \$9.3 million, an increase of approximately \$7.5 million, or 417%, from approximately \$1.8 million at December 31, 2006. This increase reflected principally the net income generated by our business during the nine months ended September 30, 2007, as well as an increase in advances by customers of approximately \$1.5 million. In May 2007, we sold convertible notes in the principal amount of \$3.4 million, from which we generated net proceeds of approximately \$3.2 million. As of September 30, 2007, we used approximately \$1.36 million to pay outstanding notes.

At September 30, 2007, we had working capital of approximately \$4.8 million, an increase of approximately \$3.8 million from working capital of approximately \$1.0 million at December 31, 2006. Our May 2007 private placement of convertible notes provided us with additional working capital. We consider current working capital and borrowing capabilities adequate to cover our planned operating and capital requirements.

Accounts payable and accrued expenses at September 30, 2007, were approximately \$454,000, an increase of approximately \$243,000, or 115%, from approximately \$211,000 at December 31, 2006, resulting from the increased level of business during the quarter.

Notes payable in the principal amount of \$3.4 million at September 30, 2007 represent our convertible notes that were sold in our May 2007 private placement. On October 4, 2007, upon our filing of articles of amendment to our articles of incorporation, these notes were automatically converted in to 9,189,189 shares of series A preferred stock, which are convertible into 3,063,063 shares of common stock and warrants to purchase a total of 4,514,367 shares of our common stock at exercise prices of \$1.50 (735,632 shares), \$2.07 (2,833,333 shares), \$2.40 (681,034 shares), \$3.00 (264,367 shares).

We believe that our working capital, together with our cash flow from operations will be sufficient to enable us to meet our cash requirements for the next 12 months. However, we may incur additional expenses as we seek to expand our business to offer services in other parts of China as well as to market and continue the development of our vocational training activities, and it is possible that we may require additional funding for that purpose. Although we do not have any current plans to make any acquisitions, it is possible that we may seek to acquire one or more businesses in the education field, and we may require financing for that purpose. We cannot assure you that funding will be available if and when we require funding.

The securities purchase agreement for our May 2007 private placement prohibits us (i) from issuing convertible debt or preferred stock until the earlier of five years from the closing or until the investors have converted or exercised and sold the securities issued in the private placement or (ii) from having debt in an amount greater than twice our EBITDA until three years from the closing or until 90% of the securities have been converted or exercised and sold. The investors in the private placement also have a right of first refusal on future financings. These provisions may make it difficult for us to raise money for our operations or for acquisitions.

## BUSINESS

### General

We are an education service company that provides on-line education and on-site training in China. We were organized to meet what our founders believe is an unmet need for educational resources throughout China. Based on the Chinese government's statistical yearbook for 2004, the government invests more than \$60 billion on education each year. According to Chinese tradition, spending on education resources is one of the family's major expenditures. However, just as economic development is not even throughout China, there is an uneven allocation of educational resources in China. In general, only those students who pass the numerous examinations which are given at various stages of the educational process, can obtain better educational opportunities at a higher level. We believe that the examination-oriented education has created a market for products from companies that address this need.

Our principal business is the distribution of educational resources through the Internet. Our website, [www.edu-chn.com](http://www.edu-chn.com), is a comprehensive education network platform which is based on network video technology and large data sources of elementary education resources. We have a data base comprised of such resources as test papers that were used for secondary education and university level courses as well as video on demand. Our data base includes more than 300,000 exams and test papers and courseware for college, secondary and elementary schools. While some of these exams were given in previous years, we engage instructors to develop new exams and a methodology for taking the exams. We market this data base under the name "Famous Instructor Test Paper Store." We also offer, through our website, video on demand, which includes tutoring of exam papers and exam techniques. We compliment the past exams and test papers by providing an interactive platform for students to understand the key points from the papers and exams. Although a number of the resources are available through our website without charge, we charge our subscribers for such services as the Famous Instructor Test Paper Store and the video on demand. Subscribers can purchase debit cards which can be used to download material from our website.

We also provide on-site teaching services in Harbin, which we market under the name "Classroom of Famed Instructors." We have a 36,600 square foot training facility in Harbin, Heilongjiang Province, China, which has 17 classrooms and can accommodate 1,200 students. These classes, which complement our on-line education services, provide classroom and tutoring to our students. The courses cover primarily the compulsory education curriculum of junior, middle and high school. We charge tuition for these classes.

We are introducing a program to of on-line vocational training services. We have collaborated with the China Vocation Education Society to set up a website, [www.360ve.com](http://www.360ve.com), which is an Internet platform for training agencies and schools to offer their services. We launched [www.360ve.com](http://www.360ve.com) in September 2007. We are calling this program our "Millions of College Students Employment Crossroad" program. We offer job search capability and career planning courses for university students. We developed this program in response to the high jobless rate for China's college graduates. Many college graduates pursue vocational training after college education in order to find employment. Our program is designed to establish a long-term training program for college students to build connections with corporations and obtain educational programs prescribed by the hiring corporations. We anticipate that we will constantly revise our materials to meet changes in the market as well as the demands of university students and graduates who enroll in our courses in order to meet their changing needs.

## Organization

We were incorporated in North Carolina on December 2, 1996 under the name of ABC Realty Co. to engage in residential real estate transactions as a broker or agent. Following the September 2004 reverse acquisition described below, our corporate name was changed to China Education Alliance, Inc. At the time of the reverse acquisition, we were not engaged in any business activity and we were considered to be a blank-check shell.

On September 15, 2004, we entered into an agreement pursuant to which:

- the stockholders of Harbin Zhong He Li Da, a Chinese corporation, transferred all of the stock of Harbin Zhong He Li Da to us and we issued to those stockholders a total of 18,333,333 share of common stock, representing 95% of our outstanding common stock after giving effect to the transaction.
- Duane Bennett, who was then our chairman of the board and controlling shareholder, caused 3,666,667 shares of common stock that were controlled by him to be transferred to us for cancellation, for which Harbin Zhong He Li Da or its stockholders paid \$400,000, of which \$300,000 was paid in cash and the balance was paid by a promissory note, which has been paid.

- We changed our corporate name to China Education Alliance, Inc. on November 17, 2004.

Our executive offices are located at 58 Heng Shan Road, Kun Lun Shopping Mall Harbin, People's Republic of China 150090, telephone number 86-451-8233-5794.

## Education Systems in China

Since 1949 when the People's Republic of China was founded, the government in China has considered education an important component of its economic and social development. Recently, with the emergence of its market economy, education has become a priority in China.

According to the National Bureau of Statistics of China for 2003, the gross domestic product of the country was calculated at \$1.41 trillion, with an annual real rate of GDP growth at 9.1%. The average Chinese family sets aside 10% of its savings for education according to the United Nations Educational, Scientific, and Cultural Organization.

We believe that many parents are willing to invest in their children for better and higher education because it is critical for their future opportunities and advancement. The educational system in China is under pressure to reform and develop. On March 14, 2004, the second session of the 10th National's People's Congress concluded that China advocates "putting people first" as its development model. The Chinese government sets education as a strategic priority in the China Agenda for Education.

The central government in China, through the Ministry of Education, manages education in China at a macro level, responsible for carrying out related laws, regulations, guidelines and policies of the central government; planning development of the education sector; integrating and coordinating educational initiatives and programs nationwide; maneuvering and guiding education reform countrywide. To a large degree, the provincial governments are left to implement basic education through development of teaching plans to supplement the required coursework from the central Ministry of Education and the funding of basic education in poorer areas. Provincial level governments have the main responsibilities for implementing basic education on a day to day basis. Since 1978, the government in China has promulgated a number of administrative regulations relating to education.

Education is funded by a variety of sources: schools directly controlled by the central government are generally funded from the central financial pool; schools controlled by local governments are supported by local governments,

the central government and fund raising projects initiated by these schools themselves; schools sponsored by township and village governments and by public institutions are mainly financed by the sponsor institutions and subsidized by local governments; private schools are funded by sponsors (including collecting tuition from students and soliciting contributions).

In China, primary and secondary education takes 12 years to complete. Primary education generally is six years, junior middle school is three years, and senior middle school is three years. Children generally begin primary school at the age of six. In 1986, China passed the Compulsory Education Law, which dictates that nine years of compulsory education (grades 1 through 9) is to become mandatory and requires that provincial and local governments take the necessary steps to ensure that all students receive at least the required nine years of education. The goal of the Compulsory Education Law, as well as the subsequent guidelines, was to universalize compulsory education and to eliminate illiteracy among the Chinese people. According to the Bulletin of Statistics on National Educational Development in 1999 issued by the Ministry of Education, the nine-year compulsory education has covered 80% of China's population since its inception. In 2002, China began to aggressively incorporate English into its elementary school curriculum.

On March 3, 2004, the State Council approved and disseminated the 2003-2007 Action Plan for Invigorating Education in the 21st Century, which was formulated by the Ministry of Education. The plan recognizes the need to make China competitive in the world economy and provides a blueprint to speed up educational reform and development in China. The plan is based on two fundamental concepts to "Rejuvenating China through Science and Education" and "Reinvigorating China through Human Resource Development." The objectives of the plan are to establish a well-to-do society and perfect the socialistic market economy in China. The plan has goals to consolidate and universalize the nine-year compulsory education program and eradicate illiteracy, to continue educational reforms, to improve the quality of education and to provide a system designed to enable the public to have access to quality education. The plan emphasizes the use of information technology in education and training.

Since 2000, the Chinese government has been implementing reform in educational policy to change the orientation of the education system from one based on memory learning to a more individualized creative approach.

### **On-line Education**

Our core business is the exam-oriented education in junior, middle, and high school. We believe that our on-line education programs are in line with the government policy of using information technology to make educational resources available throughout the country. The reforms in education policy has created a demand for new curriculum, updated educational materials and educational resources. Our portal enables our customers to access the new curriculum created by various levels of government and leading academic experts, which are endorsed by the Ministry of Education. Our courses have the necessary certification or registration with the Ministry of Education.

Our website makes use of its Internet network resources beyond the traditional teaching methods and face-to-face constraints by providing students with access to multi-media resources such as college, middle school and elementary school test papers, courseware designed to prepare students for taking the exams, and video on demand courseware. We market our website as a platform to offer services like "Famed Instructors Test Paper Store" by offering prepaid rechargeable learning debit cards that can be to purchase our products. The learners can materials downloaded for off-line education or study the material on-line.

We believe that through our website, we can help change the uneven distribution of education resources since our material is designed for nationwide exams and, though the Internet, students can have access to our material nationwide. We sell our exam papers, test papers, and video on demand through our website [www.edu-chn.com](http://www.edu-chn.com). We offer both exams that were previously given as well as copyrighted exams that were developed by teachers who we hire for that purpose. These examinations cover Chinese primary, middle and upper school exams which are used by students who are primarily in age range of seven to 18.

We have developed some educational software and we own a database covering all levels of basic education from primary school through high school. Our plans for expansion of our business operations include the following:

- Buildup the infrastructure to ensure fast access and to satisfy the volume that would develop with increasing demand.
- Develop a nation-wide advertising campaign to increase market awareness of our products.
- Engage or employ a staff to enhance the material that we offer.
- Open branch offices in key cities. Even though our website is accessible from anywhere in China, course materials are not standardized throughout China, and there are many differences in both the course material and the resources among the different regions in China. As a result, we believe that we can best serve the students in a region by using our branch offices to employ local teachers who understand the local educational system. In this manner, we can customize our course material to meet the local educational requirements and develop face-to-face tutorial centers to further expand our revenue.

### **Training Center**

We provide on-site teaching services under the “Big Classroom of the Famed Instructors,” our state-of-the-art training center in Harbin. At this center, we offer both classroom training and one-on-one tutoring. The training center has approximately 36,600 square feet, with 17 modern classrooms and a capacity for 1,200 students. The courses cover each phase of compulsory education, of which junior, middle and high school as the key part. Our courses are complimentary type with regular school classes, and will vary depending on the age of the students as well as the progress of the class. Class subjects include math, physics, chemistry, English, Chinese. We charge students for each class taken. Thus, we determine our enrollment by the number of classes that were taken during a given period of time, and not by the number of individual students. Since the term of the classes vary, we do not schedule classes on a semester basis.

### **Vocational Training**

We are introducing a program to of on-line vocational training services. We have collaborated with the China Vocation Education Society to set up a website, [www.360ve.com](http://www.360ve.com), which is an Internet platform for training agencies and schools to offer their services. We launched [www.360ve.com](http://www.360ve.com) in September 2007. We are calling this program our “Millions of College Students Employment Crossroad” program. We offer job search capability and career planning courses for university students. We developed this program in response to the high jobless rate for China’s college graduates. Our program is designed to establish a long-term training program for college students to build connections with corporations and obtain educational programs prescribed by the hiring corporations. We anticipate that we will constantly revise our materials to meet changes in the market as well as the demands of university students and graduates who enroll in our courses in order to meet their changing needs.

Through our “Millions of College Students Employment Crossroad” program, we seek to address two problems - one of the need for the university students to find jobs and the other is to satisfy the needs of businesses to hire qualified candidates. We cooperate with business and other entities to enable us to communicate to the students who enroll in this program the companies’ requirements, including the necessary skills, so that the students can learn the needs of the businesses which they are at school and can develop educational programs in the universities to enable them to meet the educational requirements of the businesses at which they may seek employment after college and to improve their job search activities.

The China Vocational Education Society has a large number of institutional members, including provincial education bureaus and more than 1,000 vocational training schools across China. We intend to expand our strategic cooperation with training agencies, especially in the aspects of joint enrollment, the exchange of resources and on-site training agencies facilities.

In this program we work with the China Vocational Education Society, which certifies vocational certification, and coordinate our programs with the government agencies, including the education and labor ministries, to develop and evaluate programs for vocational education. We have been authorized to provide on-line vocational education and to administer the certification process for certain vocations. However, we are not yet offering these services.

During December 2006, we acquired all of the fixed assets and franchise rights of Harbin Nangang Compass Computer Training School for approximately \$1 million. The Nangang Compass Computer Training School provided classroom education resources to computer vocational school students. As a result of this acquisition, we became the exclusive partner of Beida Qingniao APTEC Software Engineering within Heilongjiang Province in China for vocational training. The acquisition included materials and resources to provide on-site education classes and patented course materials. The Nangang Compass Computer Training School currently has two principal education programs focused on network engineering and ACCP software engineering with 9 on-site classrooms and 9 multimedia/computer classrooms at two centers.

### **Marketing**

We employ sales persons who market our products to the Ministry of Education and the provincial education commissions. Although the government agencies do not purchase our product, we need to obtain their approval of the use of our programs for use in connection with the curriculum taught in the schools under their jurisdiction. We also use these marketing calls to generate information to assist us in developing new educational products and opportunities. Our sales force is also actively involved with educators in developing curriculums based on the products we produce.