MVC | CAPITAL

Dow Jones Article: MVC Capital's New Strategy Starts To Pay Off

NEW YORK (Dow Jones) -- Michael Tokarz sees himself as a kind of cheerleader for the business community, which has been demoralized in recent years by a series of high-profile corporate scandals.

The former general partner at buyout firm Kohlberg, Kravis, Roberts & Co. has regular engagements as a motivational speaker at business schools around the country. He's also on the board of directors of insurer Conseco Inc. (CNO), which emerged from the third-largest bankruptcy in U.S. history last fall and has just completed a recapitalization. "I wanted to do good things with companies that had a bad history," Tokarz said. He sees this as a way to say to businesspeople, "Don't despair. (You can) be a leader and do the right thing."

Now Tokarz wants to do the right thing by shareholders of MVC Capital (MVC), a $113 million closed-end fund and business-development company with a turbulent past. Since taking the helm last November, he has obtained shareholder approval for a more flexible investment strategy, completed a review of the fund's prior holdings in technology start-ups and started putting the remaining cash in the portfolio to work in midsize private companies in a wider variety of industries.

Investors are already seeing some relief: MVC Capital's stock price has risen 17% this year and has traded at a premium to net asset value for most of the second quarter. The S&P 500 has gained only 1.9% year-to-date. (Unlike open-end mutual funds, which issue and redeem shares upon request, closed-end funds issue a limited number of shares, which trade on a stock exchange.) As of Monday, MVC Capital's shares were trading at $9.33 each, or a 1.6% premium to their $9.18-a-share net asset value.

While the fund's past problems might seem like small potatoes compared with other high-profile collapses in greater corporate America, Tokarz argues that "MVC's was one of the most abused shareholder bases I've ever seen."

MVC was launched in 1999 under the moniker MeVC Draper Fisher Jurvetson to provide ordinary investors with access to promising young technology companies, only to stumble when the market for initial public offerings shut down and many of its holdings went bust. Along the way, it managed to lose some $200 million of its original $330 million in assets.

Last year, after an expensive proxy battle, shareholders voted to oust the prior management and bring in Tokarz. At that point, some investors were ready to cut their losses, rather than bet on new management. In January, MVC repurchased 3.8 million shares, or nearly 24% of its outstanding stock, through a tender offer.

But Tokarz said it didn't make sense to shut the fund down and return all of the money, because the expenses involved would have been a further waste of shareholder capital. Besides, MVC Capital has one very valuable asset: $159 million in realized and unrealized tax losses, some of which can be carried forward as far as 2018. That means much of the future dividends and capital gains the fund produces could be tax-free.

"My only disappointment is that I haven't been able to invest more in the company because of insider-trading rules," Tokarz said. He owns 300,000 shares.

The new strategy allows MVC to tap into the market for so-called mezzanine financing, which has grown in recent years as commercial lenders spurn midsize businesses, forcing them to turn to less traditional sources of financing.

And because much of the financing MVC Capital provides will be in the form of debt, which produces a steady stream of interest income, rather than equity, the fund is also poised to benefit from the current investor mania for dividend stocks. Other business development companies with similar investment strategies, such as American Capital Strategies (ACAS), are trading at lofty premiums to their net asset values.

Tokarz has also cut costs, paring staff and buying out an expensive lease in San Francisco and moving the firm to Purchase, N.Y. The building is owned by Phoenix Capital Partners LLC, an entity controlled by Tokarz. The chairman himself doesn't draw a regular salary, and staffers who stayed on are working at reduced pay.

But there's the prospect of a future payout, as Tokarz's agreement with MVC allows him to keep a percentage of future net income or capital gains.
Tokarz, who continues to manage his own money, is himself a major source of deal flow at MVC. His contract specifies that the fund has the right of first refusal on any deals involving debt, preferred stock or other mezzanine financing, while he has right of first refusal on deals involving equity financing.

The first two investments under the fund's new strategy have been in heavy industry and finance sectors. In May, MVC announced that it was providing $1 million in subordinated debt and $450,000 in equity financing to Vestal Manufacturing Enterprises Inc., a distributor of foundried iron and steel components, as part of Vestal's management buyout from its former parent, Walter Industries Inc. (WLT).

On the same day, the fund said it was providing $10.6 million in debt and equity financing to Octagon Management, a New York manager of leveraged loans and high-yield debt, in conjunction with a management-led buyout from JPMorgan.

Tokarz says there are another 10 to 12 deals in the pipeline, which he says is enough to put the remainder of the cash in the portfolio to work.

In the meantime, some of MVC's venture-capital investments, which had been written down sharply in prior years, are starting to appreciate. During the six months ended April 30, the board's valuation committee increased the fair value of the fund's investments in five companies: O-In Design Automation, Sygate Technologies, BlueStar Solutions, Vendio and Integral Development Corp.

The fund's investments in two other companies, Actelis Networks and CBCA Inc., were written down.

Tokarz declined to predict when MVC might be in a position to pay its first dividend, saying only that the fund "is working on being in a position to deliver a dividend."

But even if the new mezzanine strategy doesn't produce a big payoff, he thinks he can look after shareholders' interests by "earning out" the portfolio, keeping fees as low as possible and carrying the tax loss forward.

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