Equus Capital, What's Going On With All That Cash?

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Equus Capital is a CEF/BDC that has been on the rocks in recent years, They have a huge pile of cash, relatively speaking, but what are they doing with it?

Equus Capital; Updates, Insights and Opportunities

Equus Capital is a CEF fund masquerading as a BDC, and one that has been on the rocks for many years. The fund was first conceived in the early 80's and fell on hard times in the wake of the 2008 financial crisis and oil boom in the years that followed. One investment after another seemed to turn to ashes but fortunately, all was not lost. The fund is still sitting on a couple of nice investments, has plenty of exposure to energy resources when that market rebounds and a pile of cash large enough to attract even the most vehement of naysayers.

So, is EQS a closed-end fund or a BDC? The fund is currently classified as a BDC but that is dependent on the completion of a merger which began more than two years ago. The Equus Total Return Fund exchanged proportionally equal amounts of shares with MVC Capital, a functioning BDC, with the intention of a full merger between the two. Since the deal first began both EQS and MVC have been plagued with account inconsistencies that have prevented the merger from completion and put MVC's listing on the NYSE in jeopardy. This also leaves EQS status in jeopardy as it will have to eventually complete the deal or pull out and move on.

News on the deal is just about non-existent. Neither EQS nor MVC has put out any new updates in quite some time. Despite this fact someone

is buying shares of EQS and has run up the price in recent weeks. A look at the weekly charts shows prices are hitting up against 12 month highs and possibly breaking out of a bottoming pattern. A decisive break above $1.87 could easily lead to gains of 25% in the near term and up to 100% in the short to long, simply on a technical basis.

What could inspire such a move? you may be asking yourself. The fund certainly has no history of delivering returns for shareholders, what could lead the market to find such value in the portfolio and the answer is simple. After so many years of lack luster results, declining investment values and questionable efforts to merge with MVC the portfolio has been whittle down to its bare bones, is undervalued and complimented by a substantial amount of cash. At last report net assets totaled a little more than $39.6 million, up $2 million or 5% from the previous quarter. Net Asset Value per share climbed 5.7% to $3.13. With the stock trading at $1.86 the discount is a whopping -40% which provides a chance for investors to nearly double their money.

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Equus Total Return Fund Portfolio Update

The portfolio exists in 7 segments; 5th Element Tracking LLC, Biogenic Reagents, Equus Energy, Equus Media Development Company LLC, MVC Capital, Pallet One and Cash. The first two, 5th Element Tracking and Biogenic Reagents, are interest bearing debt investments worth a little less than $4 million or 10% of net assets. 5th Element is a holding company with interest in various anti-theft and tracking technologies, Biogenic Reagents is a producer/ manufacturer of organically derived activated carbon used for metallurgy and filters.

Equus Energy, LLC is a wholly owned subsidiary of Equus Total Return Fund created for the purpose of investing in energy and energy related endeavors. Two injections of cash were used to purchase oil and gas interests across several regions in Texas and Oklahoma including the Eagleford Shale play. These investments were made near the peak of the oil boom and have since been decimated by low oil and gas prices and oversupply issues. The good news is that the value of these investments has bottomed over the past few quarters, along with oil prices, and has helped to stabilize EQS NAV. Equus Energy saw an 11% decrease in value, from $4.5 to $4 million, in the second quarter and is also about 10% of the portfolio. This value is expected to at least hold steady, if not rise, in the 3rd quarter and going into 4th as oil prices trend near $45.

Equus Media Development Company was formed in an attempt to enter the entertainment industry. It is a wholly owned subsidiary whose goal was to purchase and develop a range of media including but not limited to motion pictures. An initial investment of $3 million has been whittled down to only about $213,000, primarily in unwanted media rights. At current value it is only about 0.5% of the portfolio and could be sold of to whomever will pay or simply written off with little overall impact.

The MVC Capital investment I've already hit on but here are some more details. The original deal landed Equus Total Return Fund 395,839 shares of MVC for a proportional number of shares of EQS. Since then MVC has paid a regular dividend in the form of new shares bringing the to-date total up to 453,718 (an increase of 14.6%). The bad news is that shares of MVC have fallen more than 40% from their value at the time of the original deal, the good news is that share prices have stabilized since early 2016, rising 15% from bottom, and may go higher. Long term this investment has lost more than 38% of its value, including the addition of new shares, nearer term it has gained more than15% in the first half of 2016 and represents 9% of the total EQS portfolio.

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The star of the portfolio is Pallet One, Inc. Pallet One is the largest manufacturer of wooden shipping pallets in the US. It does business throughout North America, its pallets used to ship goods worldwide. EQS holds an 18.7% stake in the company which originally cost a mere $350,000. Over the past two years the company has seen significant and sustained increases in it trailing-twelve-month EBITDA that have led to massive revaluations. In the most recent report EQS holdings increased in value by 23%, or nearly $3million, and are now worth $14.3 million, a gain of more than 4000%. Pallet One represents 36% of the portfolio and is the single largest success.

The final holding is cash. Closed-end funds and BDC's both like to keep some cash on hand, money to work with, but EQS is holding much more than you would typically find due to divestitures and sales made in preparation for its merger with MVC. Cash, temporary cash investments and cash equivalents, net of liabilities, is $13.25 million or 33.45% of the portfolio, the second largest position held by the fund. The remaining portion of the holdings, bringing the total to 100%, is held in US T-bills safely earnings their wee return.

Opportunity For Value Investors

The Equus Total Return Fund certainly offers an interesting opportunity for value investors. The 40% discount, the cash holdings and the bare bones portfolio add up to a win-win situation. The fund may consummate its merger with MVC, if so shareholder confidence is likely to boost value and narrow the discount to NAV. If not the company could use the cash to buy back its shares which, at today's prices, would only cost about $3.92 million. This would leave $9.33 million for managers to use to streamline and add on to the current portfolio, or return to shareholders in one form or another. So, the question remains, what is management doing with all that cash?

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