This article by Jim Roumell is excerpted from a letter of Roumell Asset Management.

Medley Capital Corporation (MCC) is a publicly-traded business development company ("BDC") primarily engaged in providing debt capital to a wide range of U.S. based companies. MCC is externally managed by MCC Advisors, pursuant to a management agreement. MCC Advisors is controlled by Medley Management Inc., (MDLY) a publicly-traded asset management firm, which in turn is controlled by Medley Group LLC, an entity wholly-owned by the Taube brothers, Brook and Seth.

MCC's objective is to generate current income and capital appreciation by lending to privately-held middle market companies ($25 million to $250 million enterprise value), primarily through directly originated transactions. The portfolio mostly consists of senior secured first lien term loans and senior secured second lien term loans. As a BDC, MCC distributes all available net income in the form of dividends.

MCC came to our attention as we noticed it was trading at a particularly large discount to its underlying net asset value (NAV). MCC's equity currently trades at approximately a 31% discount to reported NAV, albeit one comprised of a significant amount of illiquid bonds. As part of our analysis, we applied additional incremental losses to arrive at our own base and stress case NAV estimates. For instance, we applied additional losses of 20%, 10% and 5% for Class 5, 4 and 3 credits (performing substantially, materially or simply below expectations), respectively, to arrive at our base case. After our application of additional losses to the portfolio, we still estimated that MCC would trade at a significant discount to our base case and stress case NAVs. Even if we assume that there is a 10% permanent BDC "market" discount, the equity still appears to be an attractive value.

We believe the market has put MCC in the penalty box due to historical losses caused by poor underwriting in the past. We met with senior management in New York and they fully acknowledged the legacy underwriting issues and have undertaken initiatives to correct the past mistakes. These changes include personnel and underwriting policies. They are now focusing their new lending efforts primarily on senior secured first liens and away from second liens.

Brook Taube, Chairman and CEO of MCC, and Seth Taube, Managing Partner of MCC Advisors, together own roughly 360,000 shares of MCC stock. More noteworthy is their recent decision to set up a $50 million fund to buy MCC stock on the open market. MDLY, controlled by the brothers, invested $10 million of the roughly $50 million it had on its balance sheet and Fortress Investment invested $40 million on preferred terms. It would seem reasonable that the brothers would commit such a material amount of their money management firm's capital to MCC stock only if they believed that its shares were materially undervalued.

After thorough analysis, we concluded that the various risks are more than priced into the current stock price. We believe that over time the NAV discount will narrow significantly. In the meantime, we get paid a 10.5% dividend while we wait for our expected market appreciation.