

EQUUS TOTAL RETURN, INC.

Form 10-K

March 31, 2009

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

**ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (FEE REQUIRED)**

For the year ended December 31, 2008

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-19509

**EQUUS TOTAL RETURN, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of

**76-0345915**  
(I.R.S. Employer Identification No.)

incorporation or organization)

**2727 Allen Parkway, 13th Floor, Houston, Texas**  
(Address of principal executive offices)

**77019**  
(Zip Code)

**(713) 529-0900**

Registrant's telephone number, including area code:

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange
Common Stock	on which registered New York Stock Exchange
Securities registered pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in the definitive proxy or information statement incorporated by reference in Part III of this 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

Approximate aggregate market value of common stock held by non-affiliates of the registrant: \$26,673,554 computed on the basis of \$3.01 per share, closing price of the common stock on the New York Stock Exchange on March 30, 2009. For purposes of calculating this amount only, all directors and executive officers of the registrant have been treated as affiliates. There were 8,861,646 shares of the registrant's common stock, \$.001 par value, outstanding as of March 28, 2008. The net asset value of a share as of December 31, 2008 was \$9.16.

Portions of the Proxy Statement (to be filed) for the 2009 Annual Shareholder's meeting are incorporated by reference in Parts II and III.



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**PART I**

**Item 1. Business**

Equus Total Return, Inc. (the Fund or EQS), formerly Equus II Incorporated, is a business development company that provides comprehensive financing solutions for companies in industries that it believes will benefit from significant social and demographic trends. The Fund's registered investment adviser, Moore, Clayton Capital Advisors, Inc. (the Adviser), manages its portfolio and provides access to investment opportunities throughout the United States and internationally. The Adviser is a group company of MCC Global (MCC), an international investment advisory firm that holds 10% of the Fund's common stock as of December 31, 2008.

The Fund's investment objective is to generate current investment income and long-term capital gains by investing in the debt and equity securities of small capitalization companies, which it defines as companies with a total enterprise value of between \$15.0 million and \$75.0 million. The Adviser has indicated that it generally intends to invest its assets in sectors that are, and which it believes will continue to be, driven by significant social and demographic trends, including an aging population, increased leisure time, the globalization of business and widespread concern about the environment and increasingly scarce energy resources. As its investment adviser, the Adviser intends to implement a total return-oriented investment strategy, which will include investments in a broad mix of equity and debt securities. Reflecting the change to a total return investment strategy, the Fund expects that its investments in debt and equity securities will generate both current income and capital gains and should enable it to maintain a consistent dividend policy.

The Fund believes its investment opportunities and, consequently, its returns, are limited currently by the relatively small size of its portfolio and investments. The Fund's current portfolio size limits it to relatively modest investments (averaging \$4.1 million through December 31, 2008).

The Fund is a closed-end management investment company that has elected to be treated as a business development company under the Investment Company Act of 1940, or the 1940 Act. In order to remain a business development company it must meet certain specified requirements under the 1940 Act, including investing at least 70% of its assets in eligible portfolio companies and limiting the amount of leverage it incurs. The Fund is also a regulated investment company, or RIC, under Subchapter M of the U.S. Internal Revenue Code of 1986, or the Code. As such, it is not required to pay corporate-level income tax on the Fund's investment income. The Fund intends to maintain its RIC status, which will require that it qualify annually as a RIC by meeting certain specified requirements. For a discussion of these requirements necessary to maintain its status as a business development company and as a RIC, please see Regulation as a Business Development Company General and Certain U.S. Federal Income Tax Considerations Taxation as a Regulated Investment Company, respectively.

The Adviser and Equus Capital Administration Company, Inc., or the Administrator, and their respective officers and directors and the officers of the Fund are collectively referred to herein as Management. The Fund's principal office is located at 2727 Allen Parkway<sup>th</sup>, Floor, Houston, Texas, 77019, and the telephone number is (713) 529-0900. The Fund's corporate website is located at [www.equuscap.com](http://www.equuscap.com). The Fund makes available free of charge on its website the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed or furnished to the Securities and Exchange Commission (SEC). The Fund's shares are traded on The New York Stock Exchange under the ticker symbol EQS.

***Significant Developments in 2008***

Beginning in late 2007, the United States entered a recession, which many believe could be prolonged. As the global economy continued to deteriorate in 2008, spending by both consumers and businesses declined significantly. This reduction in spending has had an adverse effect on a number of the industries in which some of our portfolio companies operate, which has resulted in a reduction in the comparable multiples and

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market-pricing used to estimate the fair value of certain of our investments and the operating results of certain of our portfolio companies. As a result, as discussed more fully in our *Management's Discussion and Analysis of Financial Condition and Results of Operations*, our results of operations in 2008 declined significantly from our results in 2007. In addition, the availability of debt and equity capital declined significantly during 2008 due to market dislocations. Generally, the limited amount of available debt financing has shorter maturities, higher interest rates and fees and more restrictive terms than debt facilities available in the past. In addition, during 2008 the price of our common stock fell well below our net asset value, thereby making it undesirable to issue additional shares of our common stock.

Because of these challenges, our near-term strategies have shifted from originating debt and equity investments, to preserving liquidity and capital necessary to meet our operational needs and servicing our borrowing obligations. As a result, we have suspended our originations of new debt and equity investments; however, from time to time we may make advances to our existing portfolio companies. Other key initiatives that we undertook during 2008 to provide necessary liquidity include:

*Monetization of Our Portfolio.* We have been seeking to convert portions of our investment portfolio, whose fair value is subject in large part to market fluctuations, to cash.

*Suspension of dividends.* On March 24, 2009, the Fund announced a suspension of its managed distribution policy to conserve liquidity and capital.

*Line of credit.* On August 13, 2008, the Fund secured a new revolving line of credit agreement with Amegy Bank of Texas for \$7.5 million. The line of credit is intended to enable the Fund to make follow-on investments. The initial term of the agreement is through February 2010 and the loan is secured by the Fund's investments.

We believe these actions are necessary to provide long-term stockholder value. We will make our decisions with respect to the actual level of 2009 dividends on a quarter-by-quarter basis during 2009, after taking into account the minimum statutorily required level of distributions, gains and losses recognized for tax purposes, portfolio transactional events, our liquidity and our asset coverage ratio at the time of such decision.

**The Adviser and MCC**

The Fund intends to build on the success it has had since its founding through its investment advisory relationship with the Adviser. The Adviser was formed by Moore, Clayton & Co., Inc. (MCCI), a wholly-owned subsidiary of MCC, for the purpose of managing the Fund and assumed responsibility as its investment adviser on June 30, 2005. The Adviser includes a mix of investment professionals from MCC and professionals retained from Equus Capital Management Corporation, or ECMC, its previous investment adviser. When the Adviser assumed its role as its investment adviser, it also acquired the investment management infrastructure of ECMC, which facilitated the transition between investment advisers, provided continuity in its relationships with portfolio companies and maintained its market presence.

In April 2007, MCCI became a wholly-owned subsidiary of MCC when it was acquired by IFEX Innovation Finance & Equity Exchange NV, a Dutch corporation (*naamloze vennootschap*) listed on the Frankfurt Stock Exchange. IFEX then changed its name to MCC Global NV. Immediately following the acquisition of MCCI, the former shareholders of MCCI held, collectively, 83% of the outstanding ordinary shares of IFEX.

The Fund's board of directors selected the Adviser as its investment adviser in part to obtain access to the potential deal flow that it believes MCC may generate from its network of industry contacts. MCC is an international financial advisory firm, the core business of which was established in 1999. MCC has offices in Amsterdam, Houston, and Salt Lake City. MCC advises clients in structuring financial transactions which often involve investments in, and acquisitions of, growth-oriented companies. In particular, MCC seeks to capitalize on investment opportunities presented by current and anticipated demographic trends worldwide. MCC currently

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advises a variety of companies worldwide, providing them with introductions and commercial opportunities through a global network of professionals, financial intermediaries and business executives. MCC advises its clients on certain transactional and strategic alternatives, including joint ventures, mergers and acquisitions, divestitures, privatizations, restructurings and recapitalizations.

The principal stockholders of MCC are Anthony R. Moore, a member of the Fund's board of directors, Kenneth Denos, a member of the Fund's board of directors and the Fund's Chief Executive Officer, and Sharon Clayton. At the time of the appointment of the Adviser, MCCI was controlled by Anthony Moore, its Chairman, and Mr. Denos, its Chief Executive Officer. Messrs. Moore and Denos were subsequently granted shares of preferred stock in the Adviser which carried a 66.8% voting interest in the Adviser. These preferred shares carry no dividend or distribution rights. As of December 31, 2008, these executives were complemented by 20 other employees and professional contract personnel. The Fund believes that the Adviser and, indirectly, the Fund, benefit from access to MCC's network of professionals, contacts and commercial opportunities.

## **The Fund's Investment Objective**

The Fund's investment objective is to maximize the total return to stockholders in the form of current investment income and long-term capital gains by investing in the debt and equity securities of small capitalization, privately owned companies. The Fund expects the Adviser to focus its investments in industries that are, and that it believes will continue to be, driven by significant social and demographic trends, including an aging population, increased leisure time, the globalization of business and widespread concern about the environment and increasingly scarce energy resources. Accordingly, the Fund expects to invest in businesses such as medical technology and services directed toward an aging population, real estate developments positioned to benefit from an increase in the number of retirees, leisure time and family entertainment industries and subsets of the energy sector developing renewable and proven alternative sources of energy.

## **Investment Strategy**

As described under "The Fund's Investment Objective" above, the Fund has adopted a total return investment objective and the Adviser is now implementing an investment strategy consistent with this objective. The total return style combines both growth and income investments and is intended to strike a balance between the potential for gain and the risk of loss. In the growth category, the Fund is a "growth-at-reasonable-price" investor. As such, it invests primarily in privately owned companies and will consider a wide range of potential growth investments in this market. The Fund's primary aim is to identify and acquire only those equity securities that meet its criteria for selling at reasonable prices. With respect to income investments, the Adviser seeks to purchase debt instruments that it expects to generate consistent interest income for the Fund as well as long-term capital appreciation through the exercise and sale of warrants received in connection with such debt financing.

The Fund usually negotiates its investments in portfolio company securities directly with the owner or issuer of the securities acquired. The Fund attempts to reduce certain risks inherent in private equity-oriented investments by investing in a portfolio of companies involved in a variety of different industries. However, it expects that such companies and industries will benefit from the significant demographic and social trends previously discussed.

The Fund limits its initial investment in any portfolio company to no more than 15% of the Fund's net assets at the date of initial investment. However, its investment in a particular portfolio company may exceed this limitation due to follow-on investments or increases in the fair value of such investments.

The Fund seeks to invest in a portfolio company with co-investors. Other investment participants may include management of the portfolio company, other business development companies, small business investment companies, other institutional or individual investors or venture capital groups. In connection with its equity investments, the Fund and its co-investors typically comprise a controlling or substantial interest in the portfolio companies.

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### **Investment Criteria**

Consistent with its investment objective and strategy, Management evaluates prospective investments based upon the criteria set forth below. Management may modify some or all of these criteria from time to time.

*Competent management.* The Fund generally requires that its companies have an experienced management team and seek to design compensation arrangements that align the interests of the portfolio company's management with those of the Fund.

*Substantial target market.* The Fund focuses on companies whose products or services have favorable growth potential. It looks for companies with strong competitive positions in their respective markets.

*History or expectation of profitability.* The Fund looks for companies that either have been profitable historically or have a reasonable expectation that they can become profitable as a result of the proposed investment.

*Substantial equity and management participation.* The Fund looks for companies that will permit it and its co-investors to take a substantial investment position in the company and to have representation on the board of directors of the company.

*Plausible exit and potential for appreciation.* The Fund expects to dispose of its portfolio securities through public rights offerings or negotiated private sales.

### **Investment Operations**

The investment operations of the Fund consist principally of the following basic activities:

*Investment Selection.* The Fund expects that many of its investment opportunities will come from Management, other private equity investors, members of the board of directors, direct approaches from prospective portfolio companies as well as from referrals from banks, lawyers, accountants and members of the financial community. It supplements these sources through access to the relationships and network of MCC. Subject to the approval of its board of directors, the Fund may compensate certain referrals with finder's fees to the extent permissible under applicable law and consistent with industry practice.

*Due Diligence.* Once a potential investment is identified, Management undertakes a due diligence review using publicly available information and information provided by the prospective portfolio companies. Management may also seek input from consultants, investment bankers and other knowledgeable sources. The due diligence review will typically include, but is not limited to:

Review of historical and prospective financial information including audits and budgets;

On-site visits;

Review of business plans and an analysis of the consistency of operations with those plans;

Interviews with management, employees, customers and vendors of the potential portfolio company;



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Review of existing loan documents, if any;

Background checks on members of management; and

Research relating to the company, its management, industry, markets, products and services and competitors.

*Structuring Investments.* The Fund typically negotiates investments in private transactions directly with the owner or issuer of the securities acquired. The Adviser structures the terms of a proposed investment, including the purchase price, the type of security to be purchased and the future involvement of the Fund in the portfolio company's business. The Adviser seeks to structure the terms of the investment to provide for the capital needs of the portfolio company while maximizing the Fund's opportunities for current income and capital appreciation.

*Providing Management Assistance and Monitoring of Investments.* Successful private equity investments typically require active monitoring of, and significant participation in, major business decisions of portfolio

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companies. In many cases, officers of the Fund serve as members of the boards of directors of portfolio companies. Such management assistance is required of a business development company under the 1940 Act. The Fund seeks to provide guidance and management assistance with respect to such matters as capital structure, budgets, profit goals, diversification strategy, financing requirements, management additions or replacements and development of a public or private market for the securities of the portfolio company. In connection with their service as directors of portfolio companies, officers and directors of the Fund may receive and retain directors' fees or reimbursement for expenses incurred, and may participate in incentive stock option plans for non-employee directors, if any. When necessary and as requested by any portfolio company, the Adviser, on behalf of the Fund, may also assign staff professionals with financial or management expertise to assist portfolio company management on specific problems.

### **Follow-On Investments**

Following its initial investment in a portfolio company, the company may request that the Fund make follow-on investments in the company. Follow-on investments may be made to exercise warrants or other preferential rights granted to the Fund or otherwise to increase its position in a successful or promising portfolio company. The portfolio company also may request that the Fund provide additional equity or loans needed to fully implement its business plans to develop a new line of business or to recover from unexpected business problems. The Fund may make follow-on investments in portfolio companies from cash on hand or borrow all or a portion of the funds required. If the Fund is unable to make follow-on investments due to lack of available capital, the portfolio company in need of the investment may be negatively impacted and the Fund's equity interest in the portfolio company may be reduced.

### **Disposition of Investments**

The method and timing of the disposition of the Fund's investments in portfolio companies is critical to its ability to realize capital gains and minimize capital losses. The Fund may dispose of its portfolio securities through a variety of transactions, including sales of portfolio securities in underwritten public rights offerings, public sales and negotiated private sales, either to the portfolio company itself or to other investors. In addition, the Fund may distribute its portfolio securities in-kind to its stockholders. In structuring its investments, the Fund endeavors to reach an understanding with the management of the prospective portfolio company as to the appropriate method and timing of the disposition of the investment. In some cases, the Fund seeks registration rights for its portfolio securities at the time of investment which typically provide that the portfolio company will bear the cost of registration. To the extent not paid by the portfolio company, the Fund typically bears the costs of disposing of its portfolio investments.

### **Current Portfolio Companies**

For a description of the Fund's current portfolio company investments, see Management's Discussion and Analysis of Financial Condition and Results of Operations - Portfolio Investments.

### **Valuation**

On at least a quarterly basis, the Adviser values the Fund's portfolio investments. These valuations are subject to the approval and adoption of the board of directors. Valuations of the Fund's portfolio securities at fair value are performed in accordance with accounting principles generally accepted in the United States of America (GAAP).

The fair value of investments for which no market exists (including most of the Fund's investments) is determined through procedures established in good faith by the Fund's board of directors. As a general principle, the current fair value of an investment is the amount the Fund might reasonably expect to receive upon its sale in an orderly manner. There are a range of values that are reasonable for such investments at any particular time.

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Generally, cost is the primary factor used to determine fair value until a significant development affecting the portfolio company (such as updated financial results or a change in general market conditions) provides a basis for an adjustment to the valuation. The Fund bases adjustments upon such factors as the portfolio company's earnings, cash flow and net worth, the market prices for similar securities of comparable companies, an assessment of the company's current and future financial prospects and various other factors and assumptions. In the case of unsuccessful operations, the Fund may base a portfolio company's fair value upon the company's estimated liquidation value. Fair valuations are necessarily subjective, and the Adviser's estimate of fair value may differ materially from amounts actually received upon the disposition of its portfolio securities. Also, any failure by a portfolio company to achieve its business plan or obtain and maintain its financing arrangements could result in a significant and rapid change in its value.

The Fund may also use, when available, third-party transactions in a portfolio company's securities as the basis for its valuation. The Fund uses this method only with respect to completed transactions or firm offers made by sophisticated, independent investors.

To the extent that market quotations are readily available for its investments and such investments are freely transferable, the Fund values them at the closing market price on the date of valuation. For securities which are of the same class as a class of public securities but are restricted from free trading (such as Rule 144 stock), the Fund establishes its valuation by discounting the closing market price to reflect the estimated impact of illiquidity caused by such restriction. The Fund determines the fair values of its debt securities, which are generally held to maturity, on the basis of the terms of such debt securities and the financial condition of the issuer. The Fund generally values certificates of deposit at their face value, plus interest accrued to the date of valuation.

The Fund's board of directors reviews the valuation policies on a quarterly basis to determine their appropriateness and reserves the right to hire independent valuation firms to review the Adviser's valuation methodology or to conduct an independent valuation.

On a daily basis, the Fund adjusts its net asset value for the changes in the value of its publicly held securities and material changes in the value of its private securities and reports those amounts to Lipper Analytical Services, Inc. The Fund's weekly and daily net asset values appear in various publications, including *Barron's* and *The Wall Street Journal*.

## **Competition**

The Fund competes with a large number of public and private equity and mezzanine funds and other financing sources, including traditional financial services companies such as finance companies and commercial banks. Many of its competitors are substantially larger and have considerably greater financial, technical and marketing resources than it does. The Fund's competitors may have a lower cost of funds and many have access to funding sources that are not available to it. In addition, certain of its competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships and build their market shares. In addition, many of the Fund's competitors are not subject to the regulatory restrictions that the 1940 Act imposes on it as a business development company.

There is no assurance that the competitive pressures the Fund faces will not have a material adverse effect on its business, financial condition and results of operations. In addition, because of this competition, the Fund may be foreclosed from taking advantage of attractive investment opportunities and may not be able to identify and make investments that satisfy its investment objectives or meet its investment goals.

## **Properties**

The Fund's principal executive offices are located at 2727 Allen Parkway, 15<sup>th</sup> Floor, Houston, Texas 77019. The Fund believes that its office facilities are suitable and adequate for its operations as currently conducted and contemplated.

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### **Legal Proceedings**

Neither the Fund nor the Adviser is currently subject to any material legal proceedings.

### **Business Development Company Requirements**

*Qualifying Assets.* As a business development company, the Fund may not acquire any asset other than qualifying assets, as defined by the 1940 Act, unless, at the time the acquisition is made the value of its qualifying assets represent at least 70% of the value of its total assets. The principal categories of qualifying assets relevant to the Fund's business are the following:

securities purchased in transactions not involving any public offering from an issuer that is an eligible portfolio company. An eligible portfolio company is any issuer that (a) is organized and has its principal place of business in the United States, (b) is not an investment company other than a small business investment company wholly-owned by the business development company, and (c) either (i) (A) does not have any class of securities with respect to which a broker or dealer may extend margin credit, (B) is controlled by the business development company either singly or as part of a group and an affiliated person of the business development company is a member of the issuer's board of directors, or (C) has total assets of not more than \$4 million and capital and surplus of at least \$2 million, or (ii) does not have any class of securities listed on a national securities exchange. Qualifying assets may also include follow-on investments in a company that was a particular type of eligible portfolio company at the time of the business development company's initial investment, but subsequently did not meet the definition;

securities received in exchange for or distributed with respect to securities described above, or pursuant to the exercise of options, warrants or rights relating to such securities; and

cash, cash items, government securities, or high quality debt securities maturing in one year or less from the time of investment. The Fund may not change the nature of its business so as to cease to be, or withdraw its election as, a business development company unless authorized by vote of the holders of the majority of its outstanding voting securities, as defined in the 1940 Act.

To include certain securities above as qualifying assets for the purpose of the 70% test, a business development company must make available to the issuer of those securities significant managerial assistance, such as providing significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company. The Fund offers to provide significant managerial assistance to each of its portfolio companies.

*Temporary Investments.* Pending investment in portfolio companies, the Fund invests its available funds in interest-bearing bank accounts, money market mutual funds, U.S. Treasury securities and/or certificates of deposit with maturities of less than one year (collectively, "Temporary Investments"). Temporary Investments may also include commercial paper (rated or unrated) and other short-term securities. Temporary Investments constituting cash, cash items, securities issued or guaranteed by the U.S. Treasury or U.S. Government agencies and high quality debt securities (commercial paper rated in the two highest rating categories by Moody's Investor Services, Inc. or Standard & Poor's Corporation, or if not rated, issued by a company having an outstanding debt issue so rated, with maturities of less than one year at the time of investment) will qualify for determining whether the Fund has 70% of its total assets invested in qualifying assets or in qualified Temporary Cash Investments for purposes of the business development company provisions of the 1940 Act.

*Leverage.* The Fund is permitted by the 1940 Act, under specified conditions, to issue multiple classes of senior debt and a single class of preferred stock senior to the common stock if its asset coverage, as defined in the 1940 Act, is at least 200% after the issuance of the debt or the senior stockholders' interests. In addition,

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provisions must be made to prohibit any distribution to common stockholders or the repurchase of any shares unless the asset coverage ratio is at least 200% at the time of the distribution or repurchase.

*Fund Share Sales Below Net Asset Value.* The Fund generally may sell its common stock at a price that is below the prevailing net asset value per share only upon the approval of the policy by stockholders holding a majority of its issued shares, including a majority of shares held by nonaffiliated stockholders. The Fund may, in accordance with certain conditions established by the SEC, sell shares below net asset value in connection with the distribution of rights to all of its stockholders. The Fund may also issue shares at less than net asset value in payment of dividends to existing stockholders.

*No Redemption Rights.* Since the Fund is a closed-end business development company, its stockholders have no right to present their shares to the Fund for redemption. Recognizing the possibility that its shares might trade at a discount, the Fund's board of directors has determined that it would be in the best interest of its stockholders for the Fund to be authorized to attempt to reduce or eliminate a market value discount from net asset value. Accordingly, from time to time the Fund may, but is not required to, repurchase its shares (including by means of tender offers) to attempt to reduce or eliminate any discount or to increase the net asset value of its shares.

*Affiliated Transactions.* Many of the transactions involving the Fund and its affiliates (as well as affiliates of such affiliates) require the prior approval of a majority of the independent directors and a majority of the independent directors having no financial interest in the transactions. However, certain transactions involving closely affiliated persons of the Fund, including the Adviser and the Administrator, require the prior approval of the SEC.

## **Regulated Investment Company Tax Status**

The Fund operates to qualify as a regulated investment company under Subchapter M of the Code. If the Fund qualifies as a regulated investment company and annually distribute to its stockholders in a timely manner at least 90% of its investment company taxable income, the Fund will not be subject to federal income tax on the portion of its taxable income and capital gains the Fund distributes to its stockholders. Taxable income generally differs from net income as defined by accounting principles generally accepted in the United States of America due to temporary and permanent timing differences in the recognition of income and expenses, returns of capital and net unrealized appreciation or depreciation.

Generally, in order to maintain its status as a regulated investment company, the Fund must (i) continue to qualify as a business development company; (ii) distribute to its stockholders in a timely manner at least 90% of its investment company taxable income, as defined by the Code; (iii) derive in each taxable year at least 90% of its gross investment company income from dividends, interest, payments with respect to securities loans, gains from the sale of stock or other securities or other income derived with respect to its business of investing in such stock or securities as defined by the Code; and (iv) meet investment diversification requirements. The diversification requirements generally require us at the end of each quarter of the taxable year to have (a) at least 50% of the value of its assets consist of cash, cash items, government securities, securities of other regulated investment companies and other securities if such other securities of any one issuer do not represent more than 5% of its assets and 10% of the outstanding voting securities of the issuer and (b) no more than 25% of the value of its assets invested in the securities of one issuer (other than U.S. government securities and securities of other regulated investment companies), or of two or more issuers that are controlled by us and are engaged in the same or similar or related trades or businesses.

In addition, with respect to each calendar year, if the Fund distributes or has treated as having distributed (including amounts retained but designated as deemed distributed) in a timely manner 98% of its net capital gain income for each one-year period ending on October 31, and distribute 98% of its investment company net ordinary income for such calendar year (as well as any ordinary income not distributed in prior years), the Fund

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will not be subject to the 4% nondeductible Federal excise tax imposed with respect to certain undistributed income of regulated investment companies.

If the Fund fails to satisfy the 90% distribution requirement or otherwise fail to qualify as a regulated investment company in any taxable year, it will be subject to tax in such year on all of its taxable income, regardless of whether the Fund makes any distribution to its stockholders. In addition, in that case, all of the Fund's distributions to its stockholders will be characterized as ordinary income (to the extent of its current and accumulated earnings and profits). The Fund has distributed and currently intends to distribute sufficient dividends to eliminate its investment company taxable income.

### **Advisory and Administration Fees**

*The Adviser.* The Adviser manages the Fund's portfolio investments pursuant to an Advisory Agreement. The Adviser's services include, among other services:

Determining the composition of the portfolio of the Fund, the nature and timing of the changes therein, and the manner of implementing such changes;

Identifying, evaluating, and negotiating the structure of the investments made by the Fund;

Monitoring the performance of, and managing the Fund's investments;

Determining the securities and other assets that the Fund will purchase, retain, or sell and the terms on which any such securities are purchased and sold;

Arranging for the disposition of investments for the Fund; and

Other specified services.

The Adviser receives a base advisory fee at an annual rate of 2% of the net assets of the Fund, paid quarterly in arrears, as well as incentive fees in the following amounts: (i) 20% of the excess, if any, of the Fund's net investment income for a quarter that exceeds a quarterly hurdle rate equal to 2% (8% annualized) of the Fund's net assets, and (ii) 20% of the Fund's net realized capital gain less unrealized capital depreciation, paid on an annual basis. The Fund is responsible for the costs and expenses of the Fund's business, operations, and investments. These costs and expenses, include among other items:

Administration fees and expenses payable under the Administration Agreement;

Costs of proxy solicitation and meetings of stockholders and the Board;

Charges and expenses of the Fund's custodian, administrator, and transfer and dividend disbursing agent;

Compensation and expenses of the Fund's independent directors;

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Legal and auditing fees and expenses; and

Subject to Board approval, certain other reasonable costs and expenses directly allocable and identifiable to the Fund or its business or investments.

The Advisory Agreement presently continues year-to-year, provided such continuance is approved at least annually by (i) a vote of a majority of the outstanding shares of the Fund, or (ii) a majority of the independent directors of the Fund. The Advisory Agreement may be terminated at any time, without the payment of any penalty, by the board of directors or the holders of a majority of the Fund's shares on 60 days' written notice to the Adviser, and would automatically terminate in the event of its assignment (as defined in the 1940 Act).

*The Administrator.* The Administrator manages the Fund's administrative and business operations pursuant to an Administration Agreement. The Administrator provides the Fund, at the Administrator's expense, with

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office space, facilities, equipment and personnel necessary for the conduct of its business. The Fund reimburses the Administrator for the costs and expenses incurred by the Administrator in performing its obligations and providing personnel and facilities under the Administrative Agreement, provided that such reimbursements do not exceed \$0.5 million per year. The Administration Agreement may be terminated by either party without penalty upon 60 days' written notice to the other party.

### **Custodian**

The Fund acts as the custodian of its securities to the extent permitted under the 1940 Act and is subject to the restrictions imposed on self-custodians by the 1940 Act and the rules and regulations thereunder. The Fund has also entered into an agreement with Amegy Bank with respect to the safekeeping of its securities. The principal business office of Amegy Bank is 4400 Post Oak Parkway, Houston, Texas 77019.

### **Transfer and Disbursing Agent**

The Fund employs American Stock Transfer & Trust Company as its transfer agent to record transfers of the shares, maintain proxy records and to process distributions. The principal business office of the Fund's transfer agent is 59 Maiden Lane, Plaza Level, New York, NY 10007.

### **Certifications**

In July 2008, the Fund submitted to the New York Stock Exchange pursuant to Section 303A.12(a) of its Listed Company Manual, an unqualified certification of the Fund's Chief Executive Officer. In addition, certifications by the Fund's Chief Executive Officer and Chief Financial Officer have been filed as exhibits to this annual report on Form 10-K as required by the Securities Exchange Act of 1934, as amended, and the Sarbanes-Oxley Act of 2002.

### **Forward-Looking Statements**

*All statements contained herein that are not historical facts including, but not limited to, statements regarding anticipated activity are forward-looking statements within the meaning of the federal securities laws, involve a number of risks and uncertainties, and are based on the beliefs and assumptions of management, based on information currently available to management. Actual results may differ materially. In some cases, readers can identify forward-looking statements by words such as may, will, should, expect, objective, plan, intend, anticipate, believe, management believes, estimate, predict, project, potential, forecast, continue, strategy, or position or the negative of such terms or other variations of them or by comparable terminology. In particular, statements, express or implied, concerning future actions, conditions, or events, future operating results, or the ability to generate sales, income, or cash flow are forward-looking statements.*

*Among the factors that could cause actual results to differ materially are the following: (i) changes in the economic conditions in which the Fund operates negatively impacting its financial resources; (ii) certain of the Fund's competitors have substantially greater financial resources than the Fund reducing the number of suitable investment opportunities offered or reducing the yield necessary to consummate the investment; (iii) there is uncertainty regarding the value of the Fund's privately held securities that require a good faith estimate of fair value for which a change in estimate could affect the Fund's net asset value; (iv) the Fund's investments in securities of privately held companies may be illiquid which could affect its ability to realize a gain; (v) the Fund's portfolio companies could default on their loans or provide no returns on its investments which could affect the Fund's operating results; (vi) the Fund is dependent on external financing to grow its business; (vii) the Fund's ability to retain key management personnel; (viii) an economic downturn or recession could impair the Fund's portfolio companies and therefore harm its operating results; (ix) the Fund's borrowing arrangements impose certain restrictions; (x) changes in interest rates may affect the Fund's cost of capital and*



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*net operating income; (xi) the Fund cannot incur additional indebtedness unless it maintains an asset coverage of at least 200%, which may affect returns to its stockholders; (xii) the Fund may fail to continue to qualify for its pass-through treatment as a regulated investment company which could have an affect on stockholder return; (xiii) the Fund's common stock price may be volatile; and (xiv) general business and economic conditions and other risk factors described in its reports filed from time to tome with the Securities and Exchange Commission. The Fund cautions readers not to place undue reliance on any such forward-looking statements, which statements are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made.*

### **Item 1A. Risk Factors**

The following discussion outlines certain risk factors that could affect the Fund's results for 2009 and beyond and cause them to differ materially from those that may be set forth in any forward-looking statement made by us or on its behalf. Readers should carefully consider these risks and all other information contained in the annual report on Form 10-K, including the Fund's consolidated financial statements and the related notes thereto. The risks and uncertainties described below are not the only ones facing the Fund. Additional risks and uncertainties not presently known to the Fund, or not presently deemed material by the Fund, may also impair its operations and performance.

If any of the following risks actually occur, the Fund's business, financial condition, or results of operations could be materially adversely affected. If that happens, the trading price of its common stock could decline and a shareholder may lose all or part of the shareholder's investment.

#### **Risks Related to the Fund's Investments**

*Investments in small capitalization companies present certain risks that may not exist to the same degree as investments in larger, more established companies and will cause such investments to be volatile and speculative.*

The Fund currently invests, and will continue to invest, in private, small or new companies that may be in their early stages of development. Investments in these types of companies involve a number of significant risks including the following:

They typically have shorter operating histories, narrower product lines and smaller market shares than public companies, which tend to render them more vulnerable to competitors' actions and market conditions as well as general economic downturns;

They may have no earnings or experienced losses or may have limited financial resources and may be unable to meet their obligations under their securities, which may be accompanied by a deterioration in the value of their equity securities or any collateral or guarantees provided with respect to their debt;

They are more likely to depend on the management talents and efforts of a small group of persons and, as a result, the death, disability, resignation or termination of one or more of those persons could have a material adverse impact on their business and prospects and, in turn, on its investment;

They may have difficulty accessing the capital markets to meet future capital needs;

They generally have less predictable operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence and may require substantial additional capital to support their operations, finance expansion or maintain their competitive position; and

Generally little public information exists about these companies and investors in those companies generally must rely on the ability of the equity sponsor to obtain adequate information for the purposes of evaluating potential returns and making a fully informed investment decision.



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***Our financial position and results of operations could be affected adversely if a significant portion of our portfolio is invested in industries that experience adverse economic or business conditions.***

From time to time, we target specific industries in which to invest on a recurring basis. This practice could concentrate a significant portion of our portfolio in a specific industry. As of December 31, 2008, our investments in alternative energy represented 31.6% of the fair value of our portfolio. Of the 31.6% invested, 29.4% represented investments in solar energy and 2.2% represented investments in other fuel cell power. If an industry in which we have significant investments suffers from adverse business or economic conditions, a material portion of our investment portfolio could be affected adversely, which, in turn, could adversely affect our financial position and results of operations.

***Our financial results could be affected adversely if a significant portfolio investment fails to perform as expected.***

Our total investment in companies may be significant individually or in the aggregate. As a result, if a significant investment in one or more companies fails to perform as expected, our financial results could be more negatively affected and the magnitude of the loss could be more significant than if we had made smaller investments in a greater number of companies.

Infinia Corporation., or Infinia, a developer of Stirling based products and solar technologies, is our largest portfolio investment. As of December 31, 2008, we held preferred stock in Infinia with a \$20.3 million fair value. As of December 31, 2008 and December 31, 2007, our investment in Infinia represented 29.4% and 28.8%, respectively, of the fair value of our investment portfolio.

***Currently, we are in a period of capital markets disruption and recession and we do not expect these conditions to improve in the near future. This disruption in the capital markets has contributed to the decrease in our net asset value and stock price, which has had, and could continue to, materially damage our business and operations.***

Since late 2007, and particularly during the second half of 2008, the financial services industry and the securities markets generally were materially and adversely affected by significant declines in the values of nearly all asset classes and by a lack of liquidity. These market conditions were initially triggered by declines in home prices and the values of subprime mortgages, but spread to all mortgage and real estate asset classes, to leveraged bank loans and to nearly all asset classes, including equities. For over a year, the global markets have been characterized by substantially increased volatility, short-selling and an overall loss of investor confidence, initially in financial institutions, but more recently in companies in a number of other industries and in the broader markets. We believe that the U.S. economy has entered into a period of recession and forecasts for 2009 generally call for further weakness in the economy. As of December 31, 2008, our common stock was trading at \$4.30 per share, or at 46.9% of net asset value.

We may be unable to monetize assets in a difficult market environment that precludes our target buyers from making investments at the fair values established by our board of directors. We are susceptible to the risk of significant loss if we are forced to discount the value of our investments in order to monetize assets to provide liquidity to fund operations, meet our liability maturities and to maintain compliance with our debt covenants. In addition, if the fair value of our assets declines substantially, we may fail to maintain the BDC asset coverage ratios stipulated by the 1940 Act. Any such failure would affect our ability to issue senior securities, including borrowings, pay dividends and could cause us to breach certain covenants in our credit facilities, which could materially impair our business operations. Further asset value degradation may result from circumstances that we may be unable to control, such as a severe decline in the value of the U.S. dollar, a protracted economic downturn or an operational problem that affects third parties or us. Ongoing disruptive conditions could cause our stock price and net asset value to decline, restrict our business operations and could adversely impact our results of operations and financial condition.

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***If market constraints further prevent us from obtaining additional debt or equity capital, our liquidity could be adversely affected, our business prospects could be negatively impacted, we could lose key employees and our operating results could be negatively affected.***

The current economic and capital market conditions in the U.S. have resulted in a severe reduction in the availability of debt and equity capital for the market as a whole, and financial services firms in particular. These conditions have constrained us and other companies in the financial services sector, limiting or completely preventing access to markets for debt and equity capital needed to maintain operations, continue investment originations and to grow. If these conditions continue for a prolonged period of time, or worsen in the future, we could lose key employees and access to leverage and our business prospects could be negatively impacted. In addition, the debt capital that will be available, if at all, may be at a higher cost and/or less favorable terms and conditions. Equity capital is, and may continue to be, difficult to raise because, subject to some limited exceptions, we are not generally able to issue and sell our common stock at a price below net asset value per share. In addition, issuing equity at depressed stock prices is dilutive to our stockholders, uneconomical and would impair our ability to grow. These events and inability to raise capital have resulted in the suspension of new originations, curtailed our ability to grow and had a negative impact on our liquidity and operating results. The continued inability to raise additional capital could further constrain our liquidity, negatively impact our business prospects, cause the departure of key employees and negatively impact our operating results.

***If we fail to qualify as a regulated investment company, we will have to pay corporate-level taxes on our income and our income available for distribution would be reduced significantly or eliminated.***

We have elected to be taxed for federal income tax purposes as a regulated investment company, or RIC, under Subchapter M of the Internal Revenue Code. To qualify as a RIC under the Internal Revenue Code, we must meet certain source-of-income, asset diversification and annual distribution requirements. The annual distribution requirement for a RIC is satisfied if we distribute to our stockholders at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, on an annual basis. If we do not distribute at least 98% of our annual taxable income, we generally will be required to pay an excise tax on amounts carried over and distributed to stockholders in the next year equal to 4% of the amount by which 98% of our annual taxable income exceeds the distributions from such income for the current year. We have met our distribution requirements as a RIC for 2008. However, we may have difficulty meeting the requirement to make distributions to our stockholders because in certain cases we may recognize income before or without receiving cash representing such income. Consequently, if we are unable to obtain cash from other sources to satisfy our distributions to our stockholders, we may fail to qualify as a RIC and, thus, may be subject to corporate-level income tax.

The Internal Revenue Service recently issued a Revenue Procedure that provides temporary cash flow relief to RICs, including BDCs, by allowing them to satisfy their federal tax income distribution requirements through the use of substantial amounts of their own stock, rather than solely cash or other RIC assets. Although there has been some guidance that suggests that distributions of stock consistent with the Revenue Procedure will not be viewed as violating the provisions of the 1940 Act relating to sales of shares below new asset value and do not need to be registered under the Securities Act of 1933, any such distributions require complicated compliance procedures and would be dilutive to existing stockholders. To qualify as a RIC, we must also meet certain asset diversification requirements at the end of each calendar quarter. Failure to meet these tests may, in certain instances, result in our having to dispose of certain investments quickly in order to prevent the loss of RIC status. Because most of our investments are in private companies, any such dispositions could be made at disadvantageous prices and may result in substantial losses. If we fail to qualify as a RIC for any reason and become subject to corporate-level income tax, the resulting corporate-level taxes could substantially reduce our net assets, the amount of income available for distribution and the amount of our distributions. Such a failure would have a material adverse effect on our stockholders and us.

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***There is uncertainty regarding the value of the Fund's privately held securities.***

The Fund's net asset value is based on the value the Fund assigns to its portfolio investments. The Fund determines the value of its investments in securities for which market quotations are not available as of the end of each calendar quarter, unless there is a significant event requiring a change in valuation in the interim. Because of the inherent uncertainty of the valuation of portfolio securities that do not have readily ascertainable market values, its fair value determination may differ materially from the value that would have been used had a ready market existed for the securities. The Fund determines the fair value of investments for which no market quotations are available based upon a methodology that the Fund believes reaches a reasonable estimation of fair value. The Fund's determinations of the fair value of its investments have a material impact on its net earnings through the recording of unrealized appreciation or depreciation of investments as well as its assessment of interest income recognition. These accounting items, in turn, dictate the amount of management fees the Fund pays to its investment adviser. The Fund's net asset value could be affected materially if its determinations of the fair value of its investments differ materially from values based on a ready market for these securities.

As of December 31, 2008, Metic Group plc was publicly listed on the AIM. The Fund adjusts its net asset value for changes in the value of this security on a daily basis.

***The Fund depends upon Management, including its Adviser, for its future success.***

The Fund depends upon the diligence and skill of Management, including its investment adviser, Moore, Clayton Capital Advisors, Inc., or the Adviser, to select, structure, close and monitor its investments. Effective June 30, 2005, the Fund entered into an investment advisory agreement with the Adviser (the "Advisory Agreement") concurrently with the Adviser's acquisition of the Fund's previous adviser, ECMC. Under the Advisory Agreement, Management identifies, evaluates, structures, monitors and disposes of the Fund's investments, and the services Management provides significantly impact the Fund's results of operations. The Fund's future success will depend to a significant extent on the continued service and coordination of Management. The Fund's Chief Investment Officer, Gary Forbes, has announced his intention to retire in the near future. Since Mr. Forbes has substantial investment experience and expertise and has generally been responsible for monitoring the status of the Fund's investments and maintaining relationships with its portfolio companies, his retirement could adversely affect the Fund. Although some of the professionals employed by ECMC were retained by the Adviser, the Adviser has a limited history in operating a business development company, and this lack of experience could adversely affect its future performance.

***The Adviser may not be able to implement its new investment objective successfully.***

Pursuant to advice from the Adviser, the Fund has refocused its investment objective and areas of investment from a regional focus and a record of investing in basic manufacturing and service companies to an investment strategy focused in sectors that are, and which the Fund believes will continue to be, driven by significant social and demographic trends, such as an aging population, increased leisure time, the globalization of business and widespread concern about the environment and increasingly scarce energy resources. The Fund's prior investment objective was to achieve capital appreciation and, as of August 2006, the Fund formally adopted a total return investment strategy. In order to implement this strategy, Management must analyze, due diligence, invest in, monitor and sell companies in industries in which many of them have not previously been involved. Also, its new investment strategy will require Management to investigate and monitor investments that are much more broadly dispersed geographically. In addition, Management will be required to provide valuations for investments in a broader range of securities, including debt securities, which will require expertise beyond that previously required of Management. The Fund cannot assure investors that the overall risk of their investment in the Fund will be reduced as a result of its change in investment strategy. If Management cannot achieve its investment objective successfully, the value of the shareholders investment in the Fund's common stock could decline substantially.

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*There are significant potential conflicts of interest that could impact the Fund's investment returns.*

The Fund's executive officers and directors and the partners of the Adviser serve or may in the future serve as officers, directors or principals of entities that operate in the same or related lines of business as the Fund does or of investment funds managed by its affiliates. Accordingly, they may have obligations to investors in those entities, the fulfillment of which might not be in the best interests of the Fund or its stockholders. For example, Anthony R. Moore, a director of the Fund, is a co-founder of MCCI, and the chairman of the Supervisory Board of MCC. MCC regularly advises companies and other entities on investments and acquisitions that may be suitable investments for the Fund. The Fund also notes that, while the Adviser does not currently advise other funds, it may do so in the future, and such funds, including potential new affiliated pooled investment vehicles or managed accounts not yet established, may have overlapping investment objectives and, accordingly, invest, whether principally or secondarily, in asset classes similar to those targeted by the Fund. As a result, Management may face conflicts in the allocation of investment opportunities between the Fund and other entities. Although the Adviser will endeavor to allocate investment opportunities in a fair and equitable manner, it is possible that the Fund may not be able to participate in certain investments directed by investment managers affiliated with the Adviser.

When Management identifies an investment, it must choose which investment fund should make the investment. The Fund does not invest in any portfolio company in which the Adviser or any of its affiliates has a pre-existing investment. The Fund may, in the future, co-invest on a concurrent basis with other affiliates of the Adviser, subject to compliance with existing regulatory guidance, applicable regulations and the Adviser's allocation procedures.

In the course of its investing activities, the Fund pays the Adviser management and incentive fees, and reimburses the Adviser for certain expenses it incurs. As a result, investors in the Fund's common stock invest on a gross basis and receive distributions on a net basis after expenses, resulting in a lower rate of return than one might achieve through direct investments. As a result of this arrangement, there may be times when the management team of the Adviser has interests that differ from those of the Fund's stockholders, giving rise to a conflict.

The Adviser receives a quarterly incentive fee based, in part, on the Fund's pre-incentive fee income, if any, for the immediately preceding calendar quarter. This incentive fee is subject to a quarterly hurdle rate before providing an incentive fee return to the investment adviser. To the extent the Fund or the Adviser is able to exert influence over the Fund's portfolio companies, the quarterly pre-incentive fee may provide the Adviser with an incentive to induce the Fund's portfolio companies to accelerate or defer interest or other obligations owed to the Fund from one calendar quarter to another.

*The Fund may not realize gains from its equity investments.*

The Fund frequently invests in the equity securities of its portfolio companies. Also, when the Fund makes a loan, it generally receives warrants to acquire stock issued by the borrower. Ultimately, the Fund's goal is to sell these equity interests and realize gains. These equity interests may not appreciate and, in fact, may depreciate in value. Several of its portfolio companies have experienced net losses in recent years or have negative net worth as of the most recent available balance sheet date. Also, the market value of the Fund's equity investments may fall below its estimate of the fair value of such investments before it sells them. Given these factors, there is a risk that the Fund will not realize gains upon the sale of those or other equity interests that it holds.

*The Fund may not be able to make additional investments in its portfolio companies from time to time, which may dilute its interests in such companies.*

After its initial investment in a portfolio company, the Fund may be called upon from time to time to provide additional funds to such company, or may have the opportunity to increase its investment in that company through the exercise of a warrant to purchase common stock or through follow-on investments in the debt or equity of that company. There is no assurance that the Fund will make, or have sufficient funds to make,

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any such follow-on investments. Any decision by the Fund not to make a follow-on investment or any inability on its part to make such an investment may have a negative impact on a portfolio company in need of investment and may result in a missed opportunity for the Fund to increase its participation in a successful operation. A decision not to make a follow-on investment may also dilute its equity interest in, or reduce the expected yield on, its investment.

### ***The Fund has invested in a limited number of portfolio companies.***

The Fund is classified as a non-diversified investment company under the 1940 Act, which means the Fund is not limited in the proportion of its assets that may be invested in the securities of a single issuer. As a matter of policy, the Fund does not initially invest more than 15% of the value of its net assets in a single portfolio company. However, follow-on investments, disproportionate increases or decreases in the fair value of certain portfolio companies or sales of investments may result in more than 15% of its net assets being invested in a single portfolio company at a particular time.

As of December 31, 2008, the Fund had investments in 17 entities. A consequence of a limited number of investments is that changes in business or industry trends or in the financial condition, results of operations or the market's assessment of any single portfolio company will affect the Fund's net asset value and the market price of its common stock to a greater extent than would be the case if the Fund were a diversified company holding a greater number of investments.

### ***The lack of liquidity of the Fund's privately held securities may adversely affect its business.***

The Fund's portfolio investments consist principally of securities that are subject to restrictions on sale because they are not listed or publicly traded securities. If any of these securities were to become publicly traded, the Fund's ability to sell them would still be restricted because it acquired them from the issuer in private placement transactions or because the Fund may be deemed to be an affiliate of the issuer. The Fund will not be able to sell these securities publicly without the expense and time required to register the securities under the Securities Act of 1933, as amended, and applicable state securities laws, unless an exemption from such registration requirements is available. In addition, contractual or practical limitations may restrict its ability to liquidate its securities in portfolio companies because those securities are privately held and the Fund may own a relatively large percentage of the issuer's outstanding securities. Sales may also be limited by market conditions, which may be unfavorable for sales of securities of particular issuers. The illiquidity of the Fund's investments may preclude or delay any disposition of such securities, which may make it difficult for it to obtain cash equal to the value at which it records its investments if the need arises.

### ***The Fund has limited public information regarding the companies in which it invests.***

The Fund's portfolio generally consists of securities issued by privately held companies. There is generally little or no publicly available information about such companies, and the Fund must rely on the diligence of Management to obtain the information necessary for its decision to invest in them and in order to monitor them effectively. There can be no assurance that such diligence efforts will uncover all material information about such privately held businesses necessary to make fully informed investment decisions.

### ***The Fund's portfolio companies may be highly leveraged.***

Investments in leveraged buyouts and in highly leveraged companies involve a high degree of business and financial risk and can result in substantial losses. A leveraged company's income and net assets will tend to increase or decrease at a greater rate than if borrowed money were not used. The use of leverage by portfolio companies also magnifies the increase or decrease in the value of a Fund investment as compared to the overall change in the enterprise value of a portfolio company.

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Many of the Fund's portfolio companies have incurred substantial debt in relation to their equity capital. Such indebtedness generally has a term that will require that the balance of the loan be refinanced when it matures. If a portfolio company cannot generate adequate cash flow to meet the principal and interest payments on its debt or is not successful in refinancing the debt upon its maturity, its investment could be reduced or eliminated through foreclosure on the portfolio company's assets or by the portfolio company's reorganization or bankruptcy.

A substantial portion of the debt incurred by portfolio companies may bear interest at rates that fluctuate in accordance with a stated interest rate index or the prime lending rate. The cash flow of a portfolio company may not be sufficient to meet increases in interest payments on its debt. Accordingly, the profitability of the Fund's portfolio companies, as well as the value of its investments in such companies, will depend significantly upon prevailing interest rates. In recent months the level of interest rates have increased, which will have an adverse effect on the ability of its portfolio companies to service their floating rate debt and on their profits.

Leverage may impair the ability of the Fund's portfolio companies to finance their future operations and capital needs. As a result, the ability of the Fund's portfolio companies to respond to changing business and economic conditions and to business opportunities may be limited.

### ***The Fund's business depends on external financing.***

The Fund's business requires a substantial amount of cash to operate. The Fund may borrow funds to pay contingencies or expenses or to make investments, to maintain its pass-through tax status as a RIC under Subchapter M of the Code. The Fund is permitted under the 1940 Act to borrow if, immediately after the borrowing, the Fund has an asset coverage ratio of at least 200%. That is, the Fund may borrow an amount equal to as much as 50% of the fair value of its total assets (including investments made with borrowed funds). The amount and nature of any such borrowings depend upon a number of factors over which the Fund has no control, including general economic conditions, conditions in the financial markets and the impact of the financing on the tax treatment of its stockholders. On August 13, 2008, the Fund entered into a loan agreement with Amegy Bank providing it with a credit facility not to exceed \$7.5 million. The agreement expires on February 15, 2010. The use of leverage, even on a short-term basis, could have the effect of magnifying increases or decreases in its net asset value. While the spread between the current yield on its investments and the cost of any loan would augment the stockholders' return from the Fund, if the spread narrows (because of an increase in the cost of debt or insufficient income on its investments), distributions to the stockholders could be adversely affected. This may render the Fund unable to meet its obligations to its lenders, which might then require it to liquidate some or all of its investments. There can be no assurance that the Fund would realize full value for its investments or recoup all of its capital if the Fund needed to liquidate its portfolio investments.

Many financial institutions today are unwilling to lend against a portfolio of illiquid, private securities. The make-up of the Fund's portfolio has made it more difficult for it to borrow at the level and on the terms that the Fund desires. Its borrowings have historically consisted of a revolving line of credit, the proceeds of which the Fund has used to provide liquidity for expenses and contingencies and to make new or follow-on investments, and a line of credit promissory note or margin account used quarterly to enable the Fund to achieve adequate diversification to maintain its pass-through tax status as a RIC.

The costs of borrowing money may exceed the income from the portfolio securities the Fund purchases with the borrowed money. The Fund will suffer a decline in net asset value if the investment performance of the additional securities purchased with borrowed money fails to cover their cost to the Fund (including any interest paid on the money borrowed). A decline in net asset value could affect its ability to make distributions on its common stock. The Fund's failure to distribute a sufficient portion of its net investment income and net realized capital gains could result in a loss of pass-through tax status or subject it to a 4% excise tax. If the asset coverage for debt securities issued by the Fund declines to less than 200% (as a result of market fluctuations or otherwise),



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it may be required to sell a portion of its investments when it is disadvantageous to do so. See Management's Discussion and Analysis of Financial Condition and Results of Operations.

### ***The Fund may not pay dividends.***

On March 24, 2009, the Fund announced that it suspended its managed distribution policy and payment of quarterly distributions for an indefinite period, following the distribution of the first quarter dividend to be paid on March 30, 2009. As originally implemented, the policy provided for quarterly dividends at an annualized rate equal to 10% of the Fund's market value per share as at the end of the preceding calendar year. The Fund will continue to pay out net investment income and/or realized capital gains, if any, on an annual basis as required under the Investment Company Act of 1940.

### ***The Fund operates in a highly competitive market for investment opportunities.***

The Fund competes with a large number of private equity funds and mezzanine funds, investment banks and other equity and non-equity based investment funds, investment entities, foreign investors and individuals and other sources of financing, including traditional financial services companies such as commercial banks. In recent years, the number of investment vehicles seeking small capitalization investments has increased dramatically. Many of the Fund's competitors are substantially larger and have considerably greater financial resources, and some may be subject to different and frequently less stringent regulation. As its portfolio size gets larger, the Fund expects that some of its investments will be larger as well. The Fund believes that it will face increased competition to participate in these larger transactions. These competitors may have a lower cost of funds and many have access to funding sources that are not available to the Fund. In addition, some of its competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships and build their market shares. As a result of this competition, the Fund may not be able to take advantage of attractive investment opportunities from time to time. There is no assurance that the competitive pressures the Fund faces will not have a material adverse effect on its business, financial condition, and results of operations.

### ***The Fund's investments in foreign securities, if any, may involve significant risks in addition to the risks inherent in U.S. investments.***

The Fund's investment strategy contemplates that a portion of its investments may be made in securities of foreign companies. Investing in foreign companies may expose the Fund to additional risks not typically associated with investing in U.S. companies. These risks may include fluctuations in foreign currency values, changes in exchange control regulations, political and social instability, expropriation, imposition of foreign taxes, less liquid markets and less available information than is generally the case in the United States, higher transaction costs, less government supervision of exchanges, brokers and issuers, less developed bankruptcy laws, difficulty in enforcing contractual obligations, lack of uniform accounting and auditing standards and greater price volatility.

Although most of the Fund's investments are denominated in U.S. dollars, any investments that are denominated in a foreign currency are subject to the risk that the value of a particular currency may change in relation to one or more other currencies. Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation and political developments. The Fund may employ hedging techniques to minimize these risks, but it can offer no assurance that it will, in fact, hedge currency risk or that, if it does, such strategies will be effective.

### ***An economic downturn could affect the Fund's operating results.***

An economic downturn such as the one that the worldwide economy is currently experiencing, as described further under Management's Discussion and Analysis of Financial Condition and Results of Operations, may

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adversely affect companies having an enterprise value varying from \$15.0 to \$75.0 million, which are the Fund's primary market for investments. During periods of adverse economic conditions, these companies may experience decreased revenues, financial losses, difficulty in obtaining access to financing and increased funding costs. During such periods, these companies may also have difficulty expanding their businesses and operations and may be unable to meet their debt service obligations or other expenses as they become due. Any of the foregoing developments could cause the value of the Fund's investments in these companies to decline. In addition, during periods of adverse economic conditions, the Fund may have difficulty accessing financial markets, which could make it more difficult or impossible for it to obtain funding for additional investments. These results could have a material adverse effect on its business, financial condition and results of operations.

### ***The Fund may experience fluctuations in its quarterly results.***

The Fund could experience fluctuations in its quarterly operating results due to a number of factors, including variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which it encounters competition in its markets, the ability to find and close suitable investments and general economic conditions. The volatility of its results is exacerbated by its relatively small number of investments. As a result of these factors, the shareholder should not rely on the Fund's results for any period as being indicative of performance in future periods.

### ***The due diligence process that the Fund undertakes in connection with its investments may not reveal all facts that may be relevant in connection with an investment.***

Before making its investments, the Fund conducts due diligence that it deems reasonable and appropriate based on the facts and circumstances applicable to each investment. The objective of the due diligence process is to identify attractive investment opportunities based on the facts and circumstances surrounding an investment and to prepare a framework that may be used from the date of an acquisition to drive operational achievement and value creation. When conducting due diligence, the Fund evaluates a number of important business, financial, tax, accounting, environmental and legal issues in determining whether or not to proceed with an investment. Its due diligence review with respect to a potential portfolio company typically includes, but is not limited to, a review of historical and prospective financial information including audits and budgets, on-site visits and interviews with management, employees, customers and vendors, a review of business plans and an analysis of the consistency of operations with those plans, and other research relating to the company, management, industry, markets, products and services, and competitors. Outside consultants, legal advisers, accountants and investment banks are expected to be involved in the due diligence process in varying degrees depending on the type of investment. Nevertheless, when conducting due diligence and making an assessment regarding an investment, the Fund is required to rely on resources available to it, including information provided by the portfolio company and, in some circumstances, third party investigations. The due diligence process may at times be subjective, including with respect to newly organized companies for which only limited information is available. Accordingly, the Fund cannot assure the shareholder that the due diligence investigation that it will carry out with respect to any investment opportunity will reveal or highlight all relevant facts that may be necessary or helpful in evaluating such investment opportunity. The Fund also cannot assure the shareholder that such an investigation will result in an investment being successful.

## **Risks Related to the Fund's Business and Structure**

### ***The Fund's ability to invest in private companies may be limited in certain circumstances.***

If the Fund is to maintain its status as a business development company, the Fund must not acquire any assets other than qualifying assets unless, at the time of and after giving effect to such acquisition, at least 70% of its total assets are qualifying assets. A principal category of qualifying assets relevant to the Fund's business is securities purchased in transactions not involving any public offering from an issuer that is an eligible portfolio company. Investments in companies organized outside of the United States or having a principal place of business outside of the United States are not eligible portfolio companies.

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*Any failure on the Fund's part to maintain its status as a business development company would reduce its operating flexibility.*

If the Fund does not remain a business development company, it might be regulated as a closed-end investment company under the 1940 Act, which would subject it to substantially more regulatory restrictions under the 1940 Act. This could impose tighter limitations on it in terms of the use of leverage and transactions with affiliated entities. Such developments would correspondingly decrease the Fund's operating flexibility.

*The Fund may not continue to qualify as a RIC under the Code.*

To remain entitled to the tax benefits accorded to RICs under the Code, the Fund must meet certain income source, asset diversification and annual distribution requirements. To qualify as a RIC, the Fund must derive each taxable year at least 90% of its gross income from dividends, interest, payments with respect to certain securities loans, gains from the sale of stock or other securities or foreign currencies, or other income derived with respect to its business of investing in such stock or securities or currencies and net income from interests in certain qualified publicly traded partnerships. The annual distribution requirement for a RIC is satisfied if the Fund distributes at least 90% of its ordinary net taxable income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to its stockholders on an annual basis. As discussed above in The Fund's business depends on external financing, the Fund has historically borrowed funds necessary to make qualifying investments to satisfy the Subchapter M diversification requirements. To the Fund's knowledge, the Internal Revenue Service has not provided definitive guidance on a RIC borrowing and investing in the noted manner to comply with the diversification test. If the Service were to take a contrary view to the Fund's and/or the Fund were unable to borrow sufficient funds in the future, the Fund may no longer qualify as a RIC. If the Fund fails to satisfy such diversification requirements and ceases to qualify for conduit tax treatment, it will be subject to income tax on its income and gains and will not be permitted to deduct distributions paid to stockholders. In addition, its distributions will be taxable as ordinary dividends to the extent paid from earnings and profits. The Fund may also cease to qualify as a RIC, or be subject to income tax and/or a 4% excise tax, if it fails to distribute a sufficient portion of its net investment income and net realized capital gains. The loss of its RIC qualification would have a material adverse effect on the total return, if any, obtainable from an investment in its common stock.

### **Item 1B. Unresolved Staff Comments**

None.

### **Item 2. Properties**

The Fund does not own any real estate or other physical properties. The Fund's administrative and principal executive offices are located at 2727 Allen Parkway, 13<sup>th</sup> Floor, Houston, Texas 77019. This location is leased and maintained through the Fund's Administrator. The Fund believes that these office facilities are suitable and adequate for the business as it is contemplated to be conducted.

### **Item 3. Legal Proceedings**

None.

### **Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The Fund's common stock is listed on the New York Stock Exchange under the symbol EQS. The Fund had approximately 5,100 stockholders as of December 31, 2008, 913 of which were registered holders. Registered holders do not include those stockholders whose stock has been issued in street name. As of December 31, 2008, its net asset value was \$9.16 per share of its common stock.

The following table reflects the high and low closing sales prices per share of its common stock on the New York Stock Exchange, net asset value, or NAV and quarterly dividends declared per share for the two years ended December 31, 2008, by quarter:

	2008				2007			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
High	\$ 7.13	\$ 7.32	\$ 7.34	\$ 6.30	\$ 8.81	\$ 9.30	\$ 8.85	\$ 7.72
Low	\$ 5.71	\$ 6.75	\$ 6.02	\$ 3.90	\$ 8.29	\$ 8.49	\$ 7.00	\$ 5.93
NAV	\$ 12.20	\$ 12.00	\$ 11.41	\$ 9.16	\$ 11.21	\$ 11.15	\$ 10.54	\$ 12.29
Dividends Declared	\$ 0.158	\$ 0.158	\$ 0.158	\$ 0.158	\$ 0.125	\$ 0.125	\$ 0.125	\$ 0.125

As a regulated investment company under Subchapter M of the Internal Revenue Code, the Fund is required to distribute to its stockholders, in a timely manner, at least 90% of its taxable net investment income each year. If the Fund does not distribute, in a timely manner, 98% of its taxable net capital gains and 98% of its taxable net investment income each year (as well as any portion of the respective 2% balances not distributed in the previous year), the Fund will be subject to a 4% non-deductible federal excise tax on certain undistributed income of regulated investment companies. Under the 1940 Act, the Fund is not permitted to pay dividends to stockholders unless the Fund meets certain asset coverage requirements. If taxable net investment income is retained, the Fund will be subject to federal income and excise taxes. The Fund reserves the right to retain net long-term capital gains in excess of net short-term capital losses for reinvestment or to pay contingencies and expenses. Such retained amounts, if any, will be taxable to the Fund as long-term capital gains and its stockholders will be able to claim their proportionate share of the federal income taxes paid by the fund on such gains as a credit against their own federal income tax liabilities. Stockholders will also be entitled to increase the adjusted tax basis of their Fund shares by the difference between their undistributed capital gains and their tax credit.

On October 23, 2006, the Fund announced a quarterly managed distribution policy pursuant to which the Fund issued dividends at a minimum annual rate of \$0.50 per share. The Fund declared four dividends in 2007 totaling \$4.1 million (\$0.50 per share). The Fund paid \$2.3 million in cash and issued 236,930 additional shares of stock. On February 19, 2008, the Fund revised the managed distribution policy to issue quarterly distributions at a minimum rate of 10% of the year-end closing price per share. During 2008, the Fund paid \$2.1 million in cash and issued 587,899 additional shares of stock.

The Fund declared two dividends during 2006 amounting in total to \$19.4 million (\$2.625 per share). The 2006 dividend was primarily the result of the net taxable realized gain from the sale of Champion Window Holdings, Inc. The 2006 dividends were paid in additional shares of common stock or in cash by specific election made by each shareholder. The Fund paid \$13.5 million in cash for both dividends (\$13.0 million paid on March 23, 2006 and \$0.5 million paid on December 7, 2006) and issued 787,099 additional shares of stock (729,773 shares at \$7.489 per share and 57,326 shares at \$8.081 per share).

The Fund invests in companies that are believed to have a high potential for capital appreciation, and the Fund intends to realize the majority of its profits upon the sale of its investments in portfolio companies. Consequently, most of the companies in which the Fund invests do not have established policies of paying annual

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dividends. However, a portion of the investments in portfolio securities held by the Fund consists of interest-bearing subordinated debt securities or dividend-paying preferred stock.

During the fiscal years ended December 31, 2008 and December 31, 2007, respectively, the Fund did not sell any securities that were not registered under the Securities Act of 1933.

**Item 6. Selected Financial Data**

The following is a summary of selected financial data and per share data of the Fund for the five years ended December 31, 2008 (in thousands, except per share data):

	2008	2007	2006	2005	2004
<b>(in thousands, except per share amounts)</b>					
Total investment income	\$ 3,181	\$ 4,857	\$ 6,016	\$ 2,530	\$ 6,196
Net investment (loss) income	\$ (713)	\$ (523)	\$ (102)	\$ (3,134)	\$ 3,706
Net realized gain (loss) of portfolio securities	\$ 924	\$ 5,264	\$ 19,012	\$ 1,237	\$ (5,474)
Net change in unrealized (depreciation) appreciation of portfolio securities	\$ (19,873)	\$ 7,526	\$ (4,751)	\$ 18,617	\$ 3,003
Net (decrease) increase in net assets resulting from operations	\$ (19,662)	\$ 12,267	\$ 14,159	\$ 16,720	\$ 1,236
Dividends declared	\$ 5,332	\$ 4,123	\$ 19,454	\$	\$ 3,560
Total assets	\$ 124,063	\$ 134,730	\$ 125,866	\$ 143,984	\$ 94,622
Total net assets	\$ 78,435	\$ 103,216	\$ 93,236	\$ 92,602	\$ 68,600
Net cash (used in) provided by operating activities	\$ (32,138)	\$ (18,264)	\$ 59,930	\$ (24,026)	\$ 57,265
Shares outstanding at end of year	8,565	8,401	8,164	7,377	6,507
Weighted average shares outstanding, basic and diluted:	8,429	8,251	7,949	6,948	6,462

**Per Share Data:**

	2008	2007	2006	2005	2004
Net investment (loss) income	\$ (0.08)	\$ (0.06)	\$ (0.01)	\$ (0.45)	\$ 0.57
Net realized gain (loss) of portfolio securities	\$ 0.11	\$ 0.64	\$ 2.39	\$ 0.18	\$ (0.84)
Net change in unrealized (depreciation) appreciation of portfolio securities	\$ (2.36)	\$ 0.91	\$ (0.60)	\$ 2.68	\$ 0.46
Net (decrease) increase in net amounts resulting from operations per share, basic and diluted	\$ (2.33)	\$ 1.49	\$ 1.78	\$ 2.41	\$ 0.19
Dividends declared	\$ 0.63	\$ 0.50	\$ 2.63	\$	\$ 0.57
Net asset value (including unrealized appreciation)	\$ 9.16	\$ 12.29	\$ 11.42	\$ 12.55	\$ 10.54

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview**

The Fund is a business development company that provides financing solutions for small capitalization companies. The Fund began operations in 1983. The Fund's investment objective is to generate investment income and long-term capital gains through a total return investment strategy under which it invests in debt and equity securities of small-capitalization, privately held companies.

In June 2005, the Fund retained Moore Clayton Capital Advisors, Inc., or the Adviser, as its registered investment adviser to manage its portfolio and provide access to investment opportunities. The Adviser is a group company of MCC Global NV, or MCC, an international investment advisory firm that currently holds 10% of the Fund's common stock.

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As a business development company, the Fund is required to comply with certain regulatory requirements. For instance, the Fund generally has to invest at least 70% of its total assets in qualifying assets, including securities of private U.S. companies, cash, cash equivalents, U.S. government securities and short-term high-quality debt investments. The Fund is a RIC under Subchapter M of the Code. To qualify as a RIC, the Fund must meet certain source of income and asset diversification requirements. If it complies with the provisions of Subchapter M, the Fund generally does not have to pay corporate-level income taxes on any income that distributed to the Fund's stockholders.

*Investment Income.* The Fund generates investment income from interest payable on the debt securities that it holds, dividends received on equity interests in its portfolio companies and capital gains, if any, realized upon sales of equity and, to a lesser extent, debt securities in the investment portfolio. The Fund's equity investments may include shares of common and preferred stock, membership interests in limited liability companies and warrants to purchase additional equity interests. These equity securities may or may not pay dividends, and the exercise prices of warrants that the Fund acquires in connection with debt investments, if any, vary by investment. The Fund's debt investments in portfolio companies may be in the form of senior or subordinated loans and may be unsecured or have a first or second lien on some or all of the assets of the borrower. Its loans typically have a term of three to seven years and bear interest at fixed or floating rates. Interest on these debt securities is generally payable either quarterly or semiannually. Some promissory notes held by the Fund provide that a portfolio company may elect to pay interest in cash or in kind or provide that discount interest may accrete in the form of original issue discount or payment in kind, or PIK, interest over the life of the notes by adding unpaid interest amounts to the principal balance. Amortization of principal on the Fund's debt investments is generally deferred for several years from the date of initial investment. The principal amount of these debt securities and any accrued but unpaid interest generally will become due at maturity. The Fund also earns interest income at market rates on investments in short-term marketable securities. From time to time, the Fund generates income from time to time in the form of commitment, origination and structuring fees in connection with the Fund's investments. The Fund recognizes all such fees when earned.

*Expenses.* The Fund's primary operating expenses consist of investment advisory and management fees payable to the Adviser for its work in identifying, evaluating, negotiating, closing and monitoring investments. The Adviser provides the investment professionals of the Adviser and the Fund's Administrator, Equus Capital Administration Company, Inc., and their respective staffs, as well as access to the investment professionals of the Administrator. The Adviser also provides and pays for the management services necessary to run the Fund's business. Under the Advisory Agreement between the Adviser and the Fund, the Adviser receives a management fee equal to an annual rate of 2% of the net assets of the Fund, which is paid quarterly in arrears. Under the Advisory Agreement, the Fund also agreed to pay an incentive fee to the Adviser based on both realized investment income and net realized capital gains less unrealized capital depreciation. This incentive fee is equal to (a) 20% of the excess, if any, of the Fund's net investment income for each quarter that exceeds a quarterly hurdle rate equal to 2% (8% annualized) of the Fund's net assets, and (b) 20% of the Fund's net realized capital gain less unrealized capital depreciation. The incentive fee calculated in clause (b) is paid on an annual basis. The Fund's Administrator provides administrative services to it, for which the Fund pays an administrative fee. Under the administration agreement the Fund entered into with the Administrator on June 30, 2005, the Fund reimburses the Administrator for its costs and expenses in performing its obligations and providing personnel and facilities up to a maximum of \$0.5 million per year.

*Operating Activities.* The Fund uses cash to make new investments and follow-on investments in its existing portfolio companies. The Fund records these investments at cost on the applicable trade date. Realized gains or losses are computed using the specific identification method. On an ongoing basis, the Fund carries its investments in its financial statements at fair value, as determined by the Fund's board of directors. See Significant Accounting Policies Valuation below. As of December 31, 2008, the Fund had invested 70% of its net assets in securities of portfolio companies that constituted qualifying investments under the 1940 Act. At that time, the Fund had invested 8.1% by value in shares of common stock, 20.2% in membership interests in limited liability companies, 25.5% in preferred stock and 33.8% in various debt instruments. Also as of

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December 31, 2008, the Fund had invested the proceeds of borrowings on margin (as discussed below under *Financing Activities*) in short-term, highly liquid investments, consisting primarily of U.S. Treasury Bills, interest-bearing bank accounts and certificates of deposit, that are, in the opinion of the Adviser, appropriate for the preservation of the principal amount of such instruments.

Under certain circumstances, the Fund makes follow-on investments in some of its portfolio companies. As of December 31, 2008, the Fund had commitments to make \$4.2 million in investments in two existing portfolio companies. The Fund is committed to \$3.2 million in HealthSPAC, LLC and \$1.0 million to RP&C Investments International LLC. See *Portfolio Companies HealthSPAC LLC* and *Portfolio Companies RP&C Investments International LLC* below.

*Financing Activities.* From time to time, the Fund uses leverage to finance a portion of its investments. The Fund then repays such debt from the sale of portfolio securities. Under the 1940 Act, the Fund has the ability to borrow funds and issue debt securities or preferred stock, which are referred to as senior securities, subject to certain restrictions including an overall limitation on the amount of outstanding debt, or leverage, relative to equity of 1:1. Because of the nature and size of the Fund's portfolio investments, it periodically borrows funds to make qualifying investments in order to maintain its qualification as a RIC. During 2008 and 2007, the Fund borrowed such funds by accessing a margin account with a securities brokerage firm. The Fund invests the proceeds of these margin loans in high-quality securities such as U.S. Treasury securities until they are repaid. The Fund refers to these high-quality investments as *restricted assets* because they are not generally available for investment in portfolio companies under the terms of borrowing. If, in the future, the Fund cannot borrow funds to make such qualifying investments at the end of any future quarter, it may not qualify as a RIC and would become subject to corporate-level income tax on its net investment income and realized capital gains, if any. In addition, the Fund's distributions to stockholders would be taxable as ordinary dividends to the extent paid from earnings and profits. See *Federal Income Tax Considerations*.

*Distributions.* On March 24, 2009, the Fund announced that it suspended its managed distribution policy and payment of quarterly distributions for an indefinite period, following the distribution of the first quarter dividend to be paid on March 30, 2009. As originally implemented, the policy provided for quarterly dividends at an annualized rate equal to 10% of the Fund's market value per share as at the end of the preceding calendar year. The Fund will continue to pay out net investment income and/or realized capital gains, if any, on an annual basis as required under the 1940 Act.

*Possible Share Repurchase.* As a closed-end business development company, the Fund's shares of common stock are not redeemable at the option of stockholders, and its shares currently trade at a discount to their net asset value. The Fund's board of directors has determined that it would be in the best interests of its stockholders to reduce or eliminate this market value discount. Accordingly, the Fund has been authorized to, and may from time to time, repurchase shares of its outstanding common stock (including by means of tender offers or privately negotiated transactions) in an effort to reduce or eliminate this market discount or to increase the net asset value of the Fund's shares. The Fund is not required to undertake any such share repurchases.

## **Significant Accounting Policies**

### ***Valuation of Investments***

The valuation of portfolio companies is the most significant area of judgment impacting the Fund's financial statements. The Fund carries portfolio investments on its financial statements at fair value, with any net change in unrealized appreciation or depreciation included in the determination of net assets. The Fund performs valuations of portfolio securities in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP, and the financial reporting policies of the SEC. The applicable methods prescribed by such principles and policies are described below:

*Publicly traded portfolio securities.* The Fund values investments in companies whose securities are publicly traded at their quoted market prices at the close of business on the valuation date, less a discount to

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reflect the estimated effects of restrictions on the sale of such securities, which the Fund refers to as the valuation discount, if applicable. As of December 31, 2008, one of the Fund's portfolio securities, Metic Group plc, was publicly listed on the AIM.

The Fund adjusts its net asset value for changes in the value of this security on a daily basis. As of December 31, 2007 and 2006, the Fund had no investments in publicly traded securities.

*Privately held portfolio securities.* The Fund determines the fair value of investments for which no market exists on the basis of procedures established in good faith by its board of directors and based on input from the investment adviser and the Fund's audit committee. As a general principle, the fair value of an investment is the amount that the Fund might reasonably expect to receive upon its current sale in an orderly manner. Appraisal valuations are necessarily subjective, and the estimated values arrived at by the Fund's board of directors may differ materially from amounts actually received upon the disposition of specific portfolio securities.

Generally, cost is the primary factor the Fund uses to determine fair value until significant developments affecting a portfolio company (such as results of operations or changes in general market conditions) provide a basis for an appraisal valuation. Thereafter, the Fund carries portfolio investments at appraised values as determined quarterly by the Adviser, subject to the approval of the Fund's board of directors. The Fund typically bases its valuations upon a multiple of each portfolio company's income and/or cash flow, an assessment of the company's current and future financial prospects and various other factors and assumptions. In the case of unsuccessful operations, this appraisal may be based upon estimated liquidation value.

The Fund typically appraises its common equity investment in each portfolio company at a multiple of the free cash flow generated by such company in its most recent fiscal year, less adjustments for outstanding funded indebtedness and other senior securities such as preferred stock. In some cases, the Fund considers projections of current year free cash flow in its appraisals, and it may also consider an adjustment to the estimate of free cash flow for non-recurring items. The Fund applies multiples based on the Adviser's experience and recent transactions in the private company marketplace and cautions that these assessments are necessarily subjective in nature.

From time to time, the Fund may elect to use third-party transactions in a portfolio company's securities as the basis for its valuation of such company, although this is not the Fund's typical approach to valuation. This method of valuation is referred to as the private market method. When an external event, such as a purchase transaction, public rights offering or subsequent equity sale occurs, the Fund applies the pricing indicated by such external event to corroborate its private equity valuation. The Fund generally uses the private market method only with respect to completed transactions or firm offers made by sophisticated, independent investors.

Most of the Fund's portfolio companies use leverage, which has the effect of magnifying its return or loss on investments. For example, if a portfolio company has a total enterprise value of \$10.0 million and has \$7.5 million in funded indebtedness, the Fund values its equity at \$2.5 million. If the enterprise value of that portfolio company then increases or decreases by 20%, to \$12.0 million or \$8.0 million, respectively, the value of the equity will increase or decrease by 80%, to \$4.5 or \$0.5 million, as the case may be. This disproportionate increase or decrease in equity value relative to total asset value adds a level of volatility to the Fund's equity-oriented portfolio securities.

From time to time, some of the Fund's portfolio companies default in respect of covenants in their loan agreements. When the Fund has a reasonable belief that a portfolio company will be able to restructure its loan agreement to waive or eliminate such default or defaults, the Fund continues to value its portfolio company's securities as a going concern. If a portfolio company cannot generate adequate cash flow to meet the principal and interest payments on its debt or is not successful in refinancing its debt at maturity, the value of the Fund's investment could be reduced or eliminated through foreclosure on such portfolio company's assets or through reorganization or bankruptcy. Under such circumstances, the Fund adjusts the value of its investment in the portfolio company accordingly.



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The Fund generally holds investments in debt securities to maturity. Accordingly, the Fund determines the fair value of debt securities on the basis of the terms of the debt securities and the financial condition of the issuer. The Fund values certificates of deposit at their face value, plus interest accrued to the date of valuation. On a daily basis, the Fund adjusts net asset value for changes in the value of publicly held securities, if any, and for material changes in the value of investments in securities issued by private companies. The Fund reports these amounts to Lipper Analytical Services, Inc. Weekly, and its daily net asset values appear in various publications, including *Barron's* and *The Wall Street Journal*.

### ***Federal Income Taxes***

The Fund intends to comply with the requirements of the Code necessary for us to qualify as a RIC. So long as it complies with these requirements, the Fund generally will not be subject to corporate-level federal income taxes on otherwise taxable income (including net realized capital gains) distributed to stockholders. Therefore, the Fund did not record a provision for federal income taxes in its financial statements. As of December 31, 2008, the Fund had no capital loss carry forward as it was fully utilized during 2006. The Fund may borrow money from time to time to maintain its status as a RIC under the Code. See [Overview](#) [Financing Activities](#) above.

### ***Interest Income Recognition***

The Fund records interest income, adjusted for amortization of premium and accretion of discount, on an accrual basis to the extent that it expects to collect such amounts. The Fund stops accruing interest on investments when it determines that interest is no longer collectible. If the Fund receives any cash after determining that interest is no longer collectible, it treats such cash as payment on the principal balance until the entire principal balance has been repaid, before it recognizes any additional interest income. The Fund accretes or amortizes discounts and premiums on securities purchased over the life of the respective security using the effective yield method. The amortized cost of investments represents the original cost adjusted for the accretion of discount and/or amortization of premium on debt securities.

### ***Payment in Kind Interest***

The Fund has loans in its portfolio that may pay PIK interest. The Fund adds PIK interest, if any, computed at the contractual rate specified in each loan agreement, to the principal balance of the loan and recorded as interest income. To maintain its status as a RIC, the Fund must pay out to stockholders this non-cash source of income in the form of dividends even if it has not yet collected any cash in respect of such investments.

### ***Recent Accounting Pronouncements***

On February 12, 2008, *FASB Staff Position No. FAS 157-2 Effective Date of FASB No. 157*, or FSP 157-2 was issued, which deferred the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008, with early adoption permitted in certain cases. We deferred the adoption of SFAS 157 for our nonfinancial assets and liabilities. We are assessing the potential impact that adoption of SFAS 157 for our nonfinancial assets and liabilities may have on our financial statements.

On October 10, 2008, *FASB Staff Position No. 157-3 Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, or FSP 157-3, was issued. FSP 157-3 provides an illustrative example of how to determine the fair value of a financial asset in an inactive market. The FSP does not change the fair value measurement principles set forth in SFAS 157. Since adopting SFAS 157 in January 2008, our practices for determining the fair value of our investment portfolio have been, and continue to be, consistent with the guidance provided in the example in FSP 157-3. Therefore, our adoption of FSP 157-3 did not affect our practices for determining the fair value of our investment portfolio and does not have a material effect on our financial position or results of operations.

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In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*. This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. The fair value option established by SFAS No. 159 permits all entities to choose to measure eligible items at fair value at specified election dates. Based upon its review, the Fund has elected not to adopt SFAS No. 159 for financial liabilities that were in the portfolio as of December 31, 2008. The Fund believes that the adoption of SFAS No. 159 has had no impact on its financial position, results of operations or cash flows.

### **Current Market Conditions**

During the year ended December 31, 2008, the state of the economy in the U.S. and abroad continued to deteriorate to what many believe is a recession, which could be long-term. Banks and others in the financial services industry have continued to report significant write-downs in fair value of their assets. The failure of a number of banks and investment companies, distressed mergers and acquisitions, and the government take-over of the nation's two largest government-sponsored mortgage companies led to the passage of the \$700 billion *Emergency Economic Stabilization Act* in early October 2008. In addition, the stock market has declined significantly, with both the S&P 500 and the NYSE (on which EQS trades) declining nearly 40% between December 31, 2007 and December 31, 2008. As the recession deepened during 2008, unemployment rose and consumer confidence declined, which led to significant reductions in spending by both consumers and businesses. These events have significantly constrained the availability of debt and equity capital for the market as a whole, and the financial services sector in particular.

These and other events have also led to rising unemployment, deteriorating consumer confidence and a general reduction in spending by both consumers and business, adversely affecting a number of industries including those in which the Fund's portfolio companies operate. Further, consistent with other companies in the financial services sector, the Fund has been adversely affected by many of these events. Between December 31, 2007 and December 31, 2008, the closing price of the Fund's common stock has declined approximately 32% and is trading at a 53% discount.

### **Liquidity and Capital Resources**

The Fund generates cash primarily from sales of securities and borrowings, as well as capital gains realized upon the sale of portfolio investments. The Fund uses cash primarily to make additional investments, either in new companies or as follow-on investments in the existing portfolio companies and to pay the dividends to its stockholders.

Management is currently evaluating the impact of current market conditions on its portfolio company valuations and their ability to provide current income. Management has followed valuation techniques in a consistent manner; however, it is cognizant of current market conditions that might effect future valuations of portfolio securities. If necessary to meet the Fund's investment commitments of \$4.2 million, the Fund has secured \$7.5 million revolving line of credit facility with Amegy Bank. The Fund has not yet borrowed under this facility. The Fund believes that its operating cash flow and cash on hand will be sufficient to meet operating requirements and to finance routine capital expenditures through the next twelve months.

### **Year Ended December 31, 2008**

As of December 31, 2008, the Fund had total assets of \$124.1 million, of which \$69.0 million were invested in portfolio investments and \$8.6 million were invested in temporary cash investments. Among the Fund's portfolio investments, \$26.5 (at fair value) million were in the form of notes receivable from portfolio companies as of December 31, 2008. Of this amount, notes issued by four portfolio companies, having an aggregate value of \$12.1 million, were currently paying cash interest in accordance with their terms.

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As of December 31, 2008, the Fund also had \$45.4 million of restricted cash and temporary investments, including primarily the proceeds of a quarter-end margin loan that the Fund incurred to maintain the diversification requirements applicable to a RIC. Of this amount, \$45.0 million was invested in U.S. Treasury bills and \$0.3 million represented a required 1% brokerage margin deposit. These securities were held by a securities brokerage firm and pledged along with other assets to secure repayment of the margin loan. The Fund sold U.S. Treasury bills on January 2, 2008 and Fund subsequently repaid this margin.

*Operating Activities.* The Fund used \$32.1 million in cash for operating activities in 2008. In 2008, the Fund made investments in portfolio companies of \$19.1 million and paid fees to its advisers, directors, banks and suppliers of \$3.9 million, while realizing \$0.9 million from the disposition of portfolio securities.

*Financing Activities.* The Fund provided \$9.9 million in cash from financing activities for 2008. The Fund declared four dividends in 2008 totaling \$5.3 million (\$0.58 per share). The Fund paid \$2.1 million in cash and issued 587,899 additional shares of stock. The Fund determined that the 2008 dividend payments should be classified as a 100% qualifying dividend, with 39% allocated to capital gain and 61% allocated to return of capital as of December 31, 2008.

On August 13, 2008, the Fund entered into a credit facility with Amegy Bank which provides for borrowings having a value of up to 20% of the fair value of its portfolio investments up to \$7.5 million outstanding at any time. Amounts, if any, outstanding under this credit facility will accrue interest at an annual rate equal to the Amegy Prime Rate, plus an applicable premium as described in the credit facility and will be payable semiannually in arrears. This credit facility expires on February 15, 2010. It includes customary covenants and borrowing conditions and provides that any borrowings thereunder will be secured by liens on certain of its investments. To date, the Fund has not borrowed any amounts under this credit facility.

***Year Ended December 31, 2007***

As of December 31, 2007, the Fund had total assets of \$134.7 million, of which \$72.1 million were invested in portfolio investments and \$30.9 million were invested in temporary cash investments. Among the Fund's portfolio investments, \$27.1 (at fair value) million were in the form of notes receivable from portfolio companies as of December 31, 2007. Of this amount, notes issued by four portfolio companies, having an aggregate value of \$3.0 million, were currently paying cash interest in accordance with their terms.

As of December 31, 2007, the Fund also had \$30.3 million of restricted cash and temporary investments, including primarily the proceeds of a quarter-end margin loan that the Fund incurred to maintain the diversification requirements applicable to a RIC. Of this amount, \$30.0 million was invested in U.S. Treasury bills and \$0.3 million represented a required 1% brokerage margin deposit. These securities were held by a securities brokerage firm and pledged along with other assets to secure repayment of the margin loan. The U.S. Treasury bills matured on January 3, 2008 and Fund subsequently repaid this margin.

*Operating Activities.* The Fund used \$18.3 million in cash for operating activities in 2007. In 2007, the Fund made investments in portfolio companies of \$27.5 million and paid fees to its advisers, directors, banks and suppliers of \$6.5 million, while realizing \$6.8 million from the disposition of portfolio securities.

*Financing Activities.* The Fund used \$2.3 million in cash from financing activities for 2007. The Fund declared four dividends in 2007 totaling \$4.1 million (\$0.50 per share). The Fund paid \$2.3 million in cash and issued 236,930 additional shares of stock. The Fund determined that the 2007 dividend payments should be classified as a 100% qualifying dividend, with 100% allocated to capital gain as of December 31, 2007.

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**Results of Operations**

**Investment Income and Expense**

***Year Ended December 31, 2008 as compared to Year Ended December 31, 2007***

Total income from portfolio securities was \$2.6 million and \$3.1 million in 2008 and 2007, respectively. The decrease in total investment income from 2007 to 2008 was largely due to secession of interest payments from Creekstone Florida Holdings, LLC., which generated \$0.6 million in interest income in 2007, along with a decrease in interest due to the recapitalization of Sovereign Business Forms in 2008.

Interest from temporary cash investments was \$0.6 million in 2008 and \$1.7 million in 2007. Temporary cash investments (excluding the margin account) decreased from \$30.9 million in 2007 to \$8.6 million in 2008.

The Adviser receives management fee compensation at an annual rate of 2% of the net assets of the Fund paid quarterly in arrears. Such fees amounted to \$1.9 million and \$1.7 million in 2008 and 2007, respectively, as the Fund maintained stable average net assets over the period. The Fund's had no incentive fee expense in 2008. The Fund's estimated expenses for incentive fees for 2007 were \$0.9 million, due to the capital gains generated by the sale of Drilltec Corporation, Cedar Lodge Holdings, Inc. and final escrow payments from the 2006 sales of Champion Windows and Alenco Window Holdings, LLC. Director fees and expenses remained unchanged at \$0.4 million in 2008 as compared to 2007.

Offering costs of \$0.6 million were expensed in 2007 as the Fund abandoned the shareholders' proposal authorizing the Fund to offer and sell, or to issue rights to acquire shares of its common stock at a price below the net asset value of such stock.

As a result of the factors described above, net investment loss after expenses was (\$0.7 million) for 2008 as compared to (\$0.5 million) for 2007.

***Year Ended December 31, 2007 as compared to Year Ended December 31, 2006***

Total income from portfolio securities was \$3.1 million and \$4.2 million in 2007 and 2006, respectively. The decrease in total investment income from 2006 to 2007 was due to liquidation of a Cedar Lodge Holdings, Inc., in early 2007, which generated \$0.9 million in interest income in 2006, along with a decrease in dividend income in 2007.

Interest from temporary cash investments was \$1.7 million in 2007 and \$1.8 million in 2006. Temporary cash investments (excluding the margin account) decreased from \$51.3 million to \$30.9 million in 2007 as compared to the prior year.

The Adviser receives management fee compensation at an annual rate of 2% of the net assets of the Fund paid quarterly in arrears. Such fees amounted to \$1.7 million and \$1.8 million in 2007 and 2006, respectively, as the Fund maintained stable average net assets over the period. The Fund's estimated expenses for incentive fees for 2006 were \$0.9 million, due to the capital gains generated by the sale of Drilltec Corporation, Cedar Lodge Holdings, Inc. and final escrow payments from the 2006 sales of Champion Windows and Alenco Window Holdings, LLC. The incentive fee for 2006 was \$1.9 million, which was based primarily on capital gains generated by the sale of Champion. Director fees and expenses decreased by \$0.1 million in 2007 as compared to 2006, due primarily to an decrease in the number of board members from eight to seven, which occurred in February 2007.

Interest expense was \$0.6 million and \$0.2 million in 2007 and 2006, respectively. The decrease was due primarily to the decline in margin interest expense for borrowing U.S. Treasury bills at the end of each quarter.

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Offering costs of \$0.1 million were expensed during the third quarter of 2007 as the Fund abandoned the shareholders' proposal authorizing the Fund to offer and sell, or to issue rights to acquire shares of its common stock at a price below the net asset value of such stock.

As a result of the factors described above, net investment loss after expenses was (\$0.5 million) for 2007 as compared to (\$0.1 million) for 2006.

**Summary of New and Follow-On Investments**

*Year Ended December 31, 2008*

During the twelve months ended December 31, 2008, the Fund invested \$8.1 million in four new portfolio companies and made follow-on investments of \$11.6 million in six portfolio companies, including \$0.6 million in the form of accrued interest and dividends received in the form of additional portfolio securities, accretion of original issue discount on promissory notes and amortization of original issue premiums on promissory notes.

The following table includes significant new and follow-on investments during the year ended December 31, 2008 (in thousands):

Portfolio Company	New		Follow-On		Total
	Cash	Noncash	Cash	Noncash	
Infinia Corporation	\$	\$	\$ 5,000	\$	\$ 5,000
Riptide Entertainment, LLC			4,725		4,725
1848 Capital Partners LLC	3,000	135			3,135
London Bridge Entertainment LLC	2,500				2,500
Trulite, Inc.	1,500				1,500
Nickent Golf, Inc.			1,180	\$ 184	1,364
Metic Group plc	1,000				1,000
ConGlobal Industries Holding, Inc.				305	305
HealthSpac, LLC			208		208
Various others				7	7
	\$ 8,000	\$ 135	\$ 11,113	\$ 496	\$ 19,744

On February 11, 2008, the Fund made a follow-on investment of \$5.0 million in Infinia Corporation in the form of 160,720 Class B preferred shares.

On January 8, 2008, the Fund invested an additional \$1.6 million as a follow-on investment in Riptide Entertainment, LLC in the form of an 8% promissory note. On May 12, 2008, the Fund made a follow-on investment in Riptide Entertainment, LLC of \$3.0 million for an 8% promissory note. These investments were expected to fund the Ripley's Believe It or Not Museum franchise located in London, UK. Additional follow-on investments include 8% promissory notes for \$0.1 million on October 25, 2008, all maturing in 2013.

On January 17, 2008, the Fund invested \$3.0 million in 1848 Capital Partners, LLC, an entertainment company in the form of an 18% promissory note.

On August 19, 2008, the Fund invested \$2.5 million in London Bridge Entertainment Partners LLC, an entertainment company in the form of an 18% promissory note.

On July 30, 2008, the Fund invested \$1.5 million in Trulite, Inc., a renewable energy company, in the form of a 15% promissory note.

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On February 26, 2008, the Fund made a follow-on investment of \$1.0 million in Nickent Golf, Inc. in the form of preferred stock. The Fund invested an additional \$0.2 million in 2008, in the form of a 13% promissory note, maturing in 2009.

On August 4, 2008, the Fund invested \$1.0 million in Metic Group plc, in the form of a convertible note. On December 27, 2008, Metic was listed on the AIM, and the Fund's note was converted to 1,830,660 shares of common stock.

**Year Ended December 31, 2007**

During the twelve months ended December 31, 2007, the Fund invested \$21.2 million in five new portfolio companies and made follow-on investments of \$7.0 million in seven portfolio companies, including \$0.7 million in the form of accrued interest and dividends received in the form of additional portfolio securities, accretion of original issue discount on promissory notes and amortization of original issue premiums on promissory notes.

The following table includes significant new and follow-on investments during the year ended December 31, 2007 (in thousands):

Portfolio Company	New		Follow-On		Total
	Cash	Noncash	Cash	Noncash	
Nickent Golf, Inc	\$ 10,000	\$ 66	\$	\$	\$ 10,066
Equus Media Development Company, LLC	5,000				5,000
Riptide Entertainment LLC			3,835		3,835
Big Apple Entertainment Partners LLC	3,000				3,000
Infinia Corporation	3,000				3,000
RP&C International Investments LLC			2,009		2,009
Various others	100		525	670	1,295
	\$ 21,100	\$ 66	\$ 6,369	\$ 670	\$ 28,205

On April 3, 2007, the Fund made an investment of \$2.0 million for 13% promissory note with a maturity date of August 3, 2007 with Nickent Golf, Inc., for working capital for development and growth opportunities. On June 21, 2007, the Fund made a follow-on investment with Nickent Golf, Inc. of \$6.0 million for a 13% promissory note with a maturity date of June 20, 2011, for working capital, strategic marketing and global expansion, and received \$2.0 million in repayment of the bridge loan date April 3, 2007. On August 16, 2007, the Fund made a follow-on investment with Nickent Golf, Inc. of \$2.0 million in exchange for 2,000,000 Class A Preferred shares, for working capital for development and growth opportunities. *See subsequent events where the Fund made a follow-on investment of \$1.0 million.*

On January 30, 2007, the Fund invested \$5.0 million in Equus Media Development Company, LLC, a 100% wholly owned subsidiary which has a development financing agreement with Kopelson Entertainment for the purchase of creative material to be used for commercial exploitation in a variety of media including but not limited to the production of motion pictures.

On February 16, 2007, the Fund invested \$0.4 million as a follow-on investment in Riptide Entertainment, LLC in the form of an 8% promissory note. On April 14, 2007, the Fund made a follow-on investment in Riptide Entertainment, LLC of \$0.3 million for an 8% promissory note with a maturity date of April 12, 2012. Additional follow-on investments include 8% promissory notes for \$0.2 million on May 2, 2007, \$0.4 million on May 11, and \$2.6 million on June 18, all maturing in 2012. *See subsequent events where the Fund made a follow-on investment of \$1.6 million.*

On October 4, 2007, the Fund invested \$3.0 million in mezzanine debt in Big Apple Entertainment in the form of an 18% promissory note.

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On June 13, 2007, the Fund made an investment of \$3.0 million in exchange for 666,667 Class A Preferred Shares in Infinia Corporation, to further the company's sales and product development programs and for company operations. *See subsequent events where the Fund made a follow-on investment of \$5.0 million.*

As of December 31, 2007, the Fund made follow-on investments on RP&C International Investments LLC ( RP&C ) amounting to \$2.0 million. On September 22, 2006, the Fund made its first investment in RP&C for \$0.3 million. Then in the fourth quarter of 2006, the Fund made two more investments in RP&C amounting to \$0.4 million and \$0.6 million, respectively. These investments followed an August 4, 2006 commitment agreement where, the Fund subscribed to acquire an interest in RP&C International Investments LLC ( RP&C ). RP&C is a fund that invests in nursing and residential care homes in Europe and the subscription commitment obligates the Fund to invest up to \$11.1 million in RP&C. *See subsequent events where the Fund received \$2.2 million from RP&C.*

**Year Ended December 31, 2006**

During the twelve months ended December 31, 2006, the Fund invested \$1.3 million in two new portfolio companies and made follow-on investments of \$9.8 million in nine portfolio companies, including \$1.3 million in the form of accrued interest and dividends received in the form of additional portfolio securities, accretion of original issue discount on promissory notes and amortization of original issue premiums on promissory notes.

The following table includes significant new and follow-on investments during the year ended December 31, 2006 (in thousands):

Portfolio Company	New		Follow-On		Total
	Cash	Noncash	Cash	Noncash	
Cedar Lodge Holding, Inc.	\$	\$	\$ 8,011	\$ (109)	\$ 7,902
RP&C International Investments LLC	1,296				1,296
Conglobal Industries Holding, Inc				893	893
Riptide Entertainment LLC			500		500
Various others	40		13	468	521
	\$ 1,336	\$	\$ 8,524	\$ 1,252	\$ 11,112

On February 21, 2006, the Fund made a \$8.0 million follow-on investment to Cedar Lodge Holdings, Inc. The investment included \$0.4 million for 4,000 shares of \$100 par value share common stock and \$7.6 million for an 18% promissory note and organization costs related to the investment. For the year ended December 31, 2006, the Fund recorded \$0.1 million as amortization of premium related to its investment in the interest bearing promissory notes.

As of December 31, 2006, the Fund funded a total of three capital calls in RP&C International Investments LLC ( RP&C ) amounting to \$1.3 million. On September 22, 2006, the Fund made its first investment in RP&C for \$0.3 million. Then in the fourth quarter of 2006, the Fund made two more investments in RP&C amounting to \$0.4 million and \$0.6 million respectively. These investments followed an August 4, 2006 commitment agreement where, Equus subscribed to acquire an interest in RP&C International Investments LLC ( RP&C ). RP&C is a fund that invests in nursing and residential care homes in Europe and the subscription commitment obligates Equus to invest up to \$11.1 million in RP&C. On December 11, 2006, the Fund made a \$40,000 new investment for a 40% initial member's interest into HealthSPAC, LLC ( HealthSPAC ) and also made a commitment to spend up to \$5.0 million in HealthSPAC.

For the twelve months ended December 31, 2006, the Fund recorded \$0.9 million as amortization of original issue discount on the Fund's two non-interest bearing notes receivable from ConGlobal Industries, Inc. One note

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is through the Fund's 100% wholly-owned subsidiary, CCI-ANI Finance, LLC (CCI-ANI) and the original issue discount amounted to \$0.7 million, while the remainder of \$0.2 million was amortization of original issue discount for a receivable owed directly to the Fund from ConGlobal Industries, Inc.

On November 29, 2006, the Fund made a \$0.2 million follow-on investment for an 8% promissory note into Riptide Entertainment, LLC (Riptide) with a maturity date of November 29, 2011. On April 18, 2006, the Fund made a follow-on investment into Riptide of \$0.3 million for an 8% promissory note with a maturity date of April 18, 2011. The investment is to be used for the exclusive, worldwide license to use the trade name Dick Clark's American Bandstand in the production of live musical celebrity tribute shows.

**Realized Gains and Losses on Sales of Portfolio Securities****Year Ended December 31, 2008**

During 2008, the Fund realized net capital gains of \$0.9 million, including the following significant transactions:

Portfolio Company	Industry	Type	Realized Gain
ConGlobal Industries Holding, Inc.	Shipping products and services	Control, non-majority	\$ 625
RP&C International Investments LLC	Healthcare	Affiliate	351
Various others			(52)
			\$ 924

**Year Ended December 31, 2007**

During 2007, the Fund realized net capital gains of \$5.3 million, including the following significant transactions:

Portfolio Company	Industry	Type	Realized Gain/(Loss)
The Drilltec Corporation	Industrial products and services	Non-affiliate	\$ 3,830
Champion Window Holdings, Inc.	Residential building products	Control	1,403
Cedar Lodge Holdings, Inc.	Real estate	Control	609
TurfGrass America Inc.	Residential building products	Affiliate	(960)
Various others			382
			\$ 5,264

**Year Ended December 31, 2006**

During 2006, the Fund realized net capital gains of \$19.0 million, including the following significant transactions:

Portfolio Company	Industry	Type	Realized Gain/(Loss)
Champion Window Holdings, Inc.	Residential building products	Control	\$ 26,969
Jones Industrial Holdings, Inc.	Industrial products and services	Control	1,137
Doane PetCare Enterprises, Inc.	Consumer goods and services	Non-affiliate	1,034
Equicom, Inc.	Media	Control	(10,334)
Various others			206





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**Changes in Unrealized Appreciation/Depreciation of Portfolio Securities**

***Year Ended December 31, 2008***

During 2008, the Fund's net unrealized appreciation on investments decreased by \$19.9 million to a net unrealized depreciation position of \$3.1 million as of December 31, 2008. This decrease in appreciation resulted primarily from the decrease in the estimated fair values of Nickent Golf, Inc., Infinia Corporation and Creekstone Florida Holdings, LLC, which the Fund revalued based on current market conditions and operations in 2008. The Fund had additional increases in unrealized appreciation due to increases in fair value of three portfolio companies aggregating \$0.9 million. This change was primarily comprised of ConGlobal Industries and Sovereign Business Forms.

***Year Ended December 31, 2007***

During 2007, the Fund's net unrealized appreciation on investments increased by \$7.5 million to a net unrealized appreciation position of \$16.8 million. This increase in appreciation resulted primarily from the increase in the estimated fair value of Infinia Corporation, which the Fund revalued based on a subsequent round of financing completed in early 2008. The increase in appreciation also resulted from the transfer of \$1.0 million in net unrealized depreciation to net realized depreciation in connection with the Fund's write-off of Turf Grass Holdings, Inc. These increases were partially offset by the Fund's transfer of \$2.0 million in net unrealized appreciation to net realized appreciation related to the sale of Drilltec Corporation. The Fund had additional decreases in unrealized appreciation due to decreases in fair value of four portfolio companies aggregating \$9.0 million. This change was primarily comprised of ConGlobal Industries, PalletOne, Inc, Sovereign Business Forms and Spectrum Management LLC.

***Year Ended December 31, 2006***

During 2006, the Fund recorded an increase in net unrealized depreciation on investments of \$4.8 million from a net unrealized appreciation position of \$14.0 million to a net unrealized appreciation position of \$9.3 million. This increase in appreciation resulted primarily from the transfer of \$27.0 million and \$1.1 million in net unrealized appreciation to net realized appreciation in connection with the Fund's investment in Champion and Jones Industrial Holdings, Inc., respectively. This increase in depreciation also resulted from the transfer of \$0.4 million and \$1.0 million in net unrealized appreciation to net realized appreciation for escrow accounts related to the disposition of Alenco Window Holdings, LLC and Doane PetCare Enterprises, Inc., respectively. These increases were partially offset by the Fund's transfer of \$10.3 million and \$0.5 million in net unrealized depreciation to net realized depreciation related to the sale of Equicom, Inc. and CMC Investment, LLC, respectively. The Fund had additional decreases in unrealized appreciation due to increases in the estimated fair value of eight of its portfolio companies aggregating \$14.1 million. This change was primarily comprised of PalletOne, Inc., The Drilltec Corporation and ConGlobal Industries, Inc. resulting from improved operating performances by these companies. We had additional increases in unrealized depreciation, which resulted from decreases in the estimated fair value of two portfolio companies, amounting to \$0.1 million.

**Portfolio Securities**

During 2008, the Fund invested \$8.1 million in four new portfolio companies and made follow-on investments in six companies, including \$0.3 million in the form of accrued interest and dividends received in the form of additional portfolio securities, accretion of original issue discount on promissory notes and amortization of original issue premiums on promissory notes. As of December 31, 2008, the Fund had active investments in the following entities or portfolio companies:

***1848 Capital Partners, LLC***

1848 Capital Partners, LLC is the owner of the management and sponsor's interest in several private companies, among them: Big Apple Entertainment Partners LLC, London Bridge Entertainment Partners LLP,

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Sunbelt Diversified Enterprises LLC and, Jet Support Services, Inc. During 2008, the Fund invested \$3.0 million in the form of a promissory note with a stated interest rate of 18% maturing in January 2011.

### ***Big Apple Entertainment Partners LLC***

Big Apple Entertainment Partners LLC ( Big Apple ) is a franchisee of Ripley Attractions, Inc. formed to develop and operate the Ripley's Times Square Odditorium in New York City. During 2007, the Fund invested \$3.0 million in the form of a promissory note with a stated annual interest rate of 18% maturing in October 2009.

### ***The Bradshaw Group, Inc.***

The Bradshaw Group, Inc. ( Bradshaw ) is a resource for large volume printer users to find cost effective options for laser print equipment, service, parts and supplies. The Fund's initial investment in The Bradshaw Group consisted of 1,335,000 shares of preferred stock, a warrant to purchase 2,229,450 shares of common stock at a purchase price of \$0.01 per share which would have expired in May 2008, a promissory note in the amount of \$0.5 million with a stated annual interest rate of 15% and a promissory note in the amount of \$0.4 million which bore a stated annual interest rate equal to the prime rate (as defined therein) plus 4%. Following an October 2006 decision to exchange the original securities for various classes of preferred stock, the Fund's investment consists of 726,806 shares of Class B preferred stock with a 12.25% paid in-kind dividend, 38,750 shares of Class C preferred stock with no dividend rights, 1,042,988 shares of Class D preferred stock with a 15% paid in-kind stock dividend, 2,587,203 shares of Class E preferred stock with an 8% paid in-kind stock dividend and 2,229,450 warrants to purchase common stock at a purchase price of \$0.01 per share which expires in May 2016. This package of investments represents a fully diluted equity interest in The Bradshaw Group of 18%. Gary Forbes, a Senior Vice President of the Fund, serves on the board of directors of The Bradshaw Group.

### ***ConGlobal Industries Holding, Inc. and Affiliates***

As of December 31, 2008, the Fund's investment in ConGlobal consisted of 24,397,303 shares of common stock, and a \$3.6 million subordinated promissory note. The Fund's investment in ConGlobal represents a fully diluted equity interest of 32.2%.

In 2002, subsequent to its initial investment in ConGlobal, the Fund formed CCI-ANI Finance for the purpose of making a follow-on investment in ConGlobal by purchasing a subordinated seller note from a former owner of Container-Care International, an affiliate of ConGlobal. The Fund owns 100% of CCI-ANI Finance and, as of December 31, 2008, the Fund valued its ownership interest at \$3.0 million.

The Fund also made a \$1.0 million follow-on investment in ConGlobal in June 2005. This investment took the form of a 66.67% (67.95% at December 31, 2008) member's interest in JL Madre LLC, a holding company affiliate of ConGlobal. Members of ConGlobal's management team purchased other member's interests in JL Madre for \$0.5 million. The Fund's \$1.0 million investment also included the purchase of a 10% senior participating note issued by JL Madre. This promissory note is scheduled to mature in September 2011. At December 31, 2008, the Fund valued its investment in J.L. Madre at \$0.9 million. Gary Forbes, a Senior Vice President of the Fund, serves on the board of directors of ConGlobal.

### ***Creekstone Florida Holdings, LLC***

Creekstone Florida Holdings, LLC (Creekstone Florida) was the Fund's first investment in the real estate market. The Fund formed this investment vehicle for the purpose of holding its investment in the Creekstone Island Reserve condominium development project, which, upon completion, is expected to include 299 condominium homes and townhomes. As of December 31, 2008, the Fund's investment in Creekstone was valued at \$0 as current market conditions, particularly the downturn of the Florida real estate market, have impacted the company's ability to meet current loan covenants.

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### ***Equus Media Development Company LLC***

Equus Media Development Company, LLC ( EMDC ), a wholly-owned subsidiary of the Fund, was formed by the Fund in January 2007. EMDC has a development financing agreement with Kopelson Entertainment for the purchase of creative material to be used for commercial exploitation in a variety of media platforms, including, but not limited to the production of motion pictures. As of December 31, 2008, EMDC had several projects in development and was valued at \$5.0 million. Paula Douglass, Vice President of the Fund, serves as President of EMDC.

### ***HealthSPAC, LLC***

HealthSPAC, LLC ( HealthSPAC ) was formed to develop special purpose acquisition companies, or SPACs, focused on healthcare opportunities. HealthSPAC will identify specific industry opportunities within the healthcare sector that it believes can thrive under the SPAC financing model, with an emphasis on cash generation and opportunity for growth. As of December 31, 2008, the Fund's investment in HealthSPAC consisted of a 40% membership interest and a promissory note with a value at \$0.3 million. The Fund has a remaining commitment of \$3.2 million. Kenneth Denos, Chief Executive Officer of the Fund, serves as a director of HealthSPAC.

### ***Infinia Corporation***

Infinia Corporation ( Infinia ), based in Kennewick, WA, is a leading developer of Stirling-cycle based products and technologies. Operating without internal combustion, a Stirling engine utilizes a temperature differential to drive a piston and produce electricity. Along with other Stirling based products, Infinia is focused on commercializing a Stirling power system operating on concentrated solar energy for commercial and residential users. In June 2007, the Fund made an investment of \$3.0 million in exchange for 666,667 Class A Preferred Shares in Infinia Corporation, to further the company's sales and product development programs and for company operations. In February 2008, the Fund made a follow-on investment of \$5.0 million in exchange for 160,720 Class B preferred shares. As of December 31, 2008, the Fund recorded a significant increase in the valuation of Infinia Corporation, with an increase in unrealized appreciation of \$12.3 million on its investments. Sharon Clayton, Co-Chairman of the Adviser, serves on the Board of Directors of Infinia Corporation.

### ***London Bridge Entertainment Partners LLC***

London Bridge Entertainment Partners LLC is a franchisee of Ripley Attractions, Inc. formed to develop and operate the Ripley's Believe It Or Not Museum located in Piccadilly Circus, London. During 2008, the Fund invested \$2.5 million in the form of a promissory note with a stated annual interest rate of 18% maturing in August 2010.

### ***Metic Group plc***

Metic Group plc ( Metic ) is the largest provider of specialist architectural roof glazing for commercial buildings in the United Kingdom and one of the leaders in the UK glass facade industry. Its products fall into the broad categories of facades, roof systems, internal glazing and specialist structures, with facades and roof systems accounting for the majority of its revenues. Metic is involved in projects in both the public sector (hospitals, universities, colleges and schools) and the private sector (offices, shopping centers and arenas). A growing proportion of the Company's revenues are derived outside the UK, particularly the Middle East and South America. In December 2008, the Fund's investment of \$1.0 million was converted to common shares when Metic listed on London's AIM market under the symbol METC.L.

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***Nickent Golf, Inc.***

Nickent Golf, Inc. ( Nickent ) based in City of Industry, CA, is a market leader in the rapidly expanding, hybrid club segment of the golf industry and is an emerging leader in game-enhancement technology. Nickent's development process is driven by its dedication to advanced technologies and focus on design innovation. Nickent is the official OEM sponsor of the Golf Channel's Nationwide Tour coverage. As of December 31, 2008, the Fund's investment in Nickent has a cost of \$9.4 million and a value of \$0.2 million, which consists of promissory notes with a stated annual interest rate of 13% along with 3 million shares of Class A convertible preferred stock and warrants to purchase 600,830 shares of common stock. On January 2, 2009, the Fund announced a write down of its debt and equity investment in Nickent based on Nickent's current financial condition and the effects of the market economy on Nickent's business. The remaining fair value of the Fund's investment represents a short-term loan secured by certain accounts receivable of Nickent. Anthony R. Moore, a Director of the Fund and a director of the Adviser, serves on the board of directors of Nickent Golf, Inc. as its chairman.

***PalletOne, Inc.***

The Fund understands that PalletOne, Inc. ( PalletOne ) is the largest wooden pallet manufacturer in the United States, operating 16 facilities in eleven states. PalletOne also owns and operates a major Florida-based wood treating plant. PalletOne has a diverse customer base and competes with numerous other manufacturers on a regional basis. As of December 31, 2008, the Fund's investment in PalletOne consisted of 350,000 shares of common stock, which represent a fully diluted equity interest of approximate 19%. The investment was valued at zero as PalletOne and its industry have been impacted severely by the recession in the homebuilding industry. Gary Forbes, a Senior Vice President of the Fund, serves on the board of directors of PalletOne.

***Riptide Entertainment LLC***

Riptide Entertainment LLC ( Riptide ) was formed to develop, own and operate family entertainment properties throughout the world. As of December 31, 2008, the Fund's investment in Riptide Entertainment had a cost and value of \$9.6 million, which consisted of promissory notes having principal amounts totaling \$7.4 million and a stated annual interest rate of 8%, together with an investment of \$0.1 million in the form of a 64.67% member's interest in Riptide Entertainment. Anthony R. Moore, a Director of the Fund and Gary Forbes, a Senior Vice President of the Fund, serve as directors of Riptide.

***RP&C International Investments LLC***

On August 11, 2006, the Fund committed to invest up to \$11.1 million to acquire a 17.2% equity interest in RP&C International Investments LLC ( RP&C ). RP&C is an investment fund formed for the purpose of investing in mezzanine loans or preferred equity interests to be issued by nursing and residential care homes in the United Kingdom or Germany. Each eligible facility must be fully licensed, receive its cash flow directly or indirectly from governmental or government-supported sources in such jurisdictions and meet certain other operating criteria. This fund's investments in facilities are expected to have a term of one to four years, yield at least 9% per annum and benefit from a pledge of the equity in such facilities and various operating covenants and conditions. As of December 31, 2008, the Fund's investment in RP&C represents an approximate 17% member's interest and consisted of a \$0.5 million loan that is scheduled to earn interest at 9% payable quarterly in arrears. Anthony R. Moore, a Director of the Fund and Kenneth Denos, Chief Executive Officer of the Fund, serve on the Investment Committee of RP&C.

***Sovereign Business Forms, Inc.***

Sovereign Business Forms, Inc. ( Sovereign ) was founded in 1996 to participate in the consolidation of the highly fragmented, wholesale business forms industry. Today, the Fund understands that Sovereign is one of the

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ten largest manufacturers and wholesalers of custom business forms in the United States. Sovereign operates five manufacturing plants with a combined market reach covering much of the central and eastern United States, Texas and Louisiana. As of December 31, 2008, the Fund's investment in Sovereign consisted of a 12% subordinated promissory note in the principal amount of \$3.2 million and 1,214,630 shares of common stock. The Fund believes its investment represents a fully diluted equity interest in Sovereign of 55.25%. As of December 31, 2008, the Fund's investment in Sovereign comprised approximately 10.3% of its total net assets. The business forms industry is mature and highly competitive. Gary Forbes, a Senior Vice President of the Fund, serves on Sovereign's board of directors.

***Spectrum Management, LLC***

Spectrum Management, LLC (Spectrum) uses proprietary electronic tracking equipment and software, and a full suite of custom services to help client organizations protect or recover high-value merchandise and cash. This equipment and software also benefits law enforcement agencies by reducing the occurrence of robberies and by assisting in the apprehension of perpetrators. As of December 31, 2008, the Fund's investment in Spectrum Management consisted of 285,000 units of Class A Members' interest, a 16% subordinated promissory note in the amount of \$1.3 million and a 16% subordinated promissory note in the amount of \$0.4 million due May 28, 2011. The Fund believes its investment in Spectrum Management represents a fully diluted equity interest of 79%. As of December 31, 2008, the Fund's investment in Spectrum Management comprised in excess of 10.3% of the Fund's total net assets. Spectrum Management has a diverse customer base. Gary Forbes, a Senior Vice President of the Fund, serves on the board of directors of Spectrum Management.

***Trulite, Inc.***

Trulite, Inc. (Trulite) is a leader in safe, clean, affordable, portable hybrid power generation products that are also user friendly. The company's flagship product, the KH4 generator, is capable of filling existing critical power voids in the 50W through 250W power markets. The KH4 is being launched in the marketplace, and plans to fill clean power needs up to 5KW with other products that are currently in development. During 2008, the Fund invested \$1.5 million in the form of a promissory note with a stated annual interest rate of 15% maturing in August 2009. Kenneth I Denos, Chief Executive Officer of the Fund, and Paula T. Douglass, Vice Chairman of the Adviser, serve on the board of directors of Trulite, Inc.

**Off Balance Sheet Arrangements**

As of December 31, 2008 and 2007, the Fund did not have any off-balance sheet liabilities that are reasonably likely to have a current or future material effect on the Fund's financial condition, other than the investment advisory and management agreement and the administration agreement, which are described below.

**Contractual Obligations**

The Fund has entered into four contracts under which it expects to have material future commitments, the Advisory Agreement between the Fund and the Adviser, pursuant to which the Adviser has agreed to serve as the Fund's investment advisor; and the Administration Agreement between the Fund and the Administrator, pursuant to which the Administrator has agreed to furnish the Fund with the facilities and administrative services necessary to conduct the Fund's day-to-day operations and to provide managerial assistance on its behalf to portfolio companies to which the Fund is required to provide such assistance. Both the Advisory Agreement and the Administration Agreement may be terminated by either party without penalty upon not more than 60 days written notice to the other.

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The remaining commitment as of December 31, 2008 relate to the Fund's portfolio company investments and are summarized as follow (in thousands):

Portfolio Company	Original Commitment	Remaining Commitment
HealthSPAC, LLC(1)	\$ 5,000	\$ 3,227
RP&C International Investments LLC	11,100	1,000
		\$ 4,227

(1) Funding of the remaining commitment has been postponed until 2010 at the earliest.

**Dividends**

The Fund declared four dividends in 2008, totaling \$0.63 per share. The 2008 dividends were 100% qualified and classified as 39% capital gains distribution and 61% return of capital. The Fund declared four dividends in 2007 totaling \$0.50 per share. The 2007 dividends were 100% qualifying and classified as capital gain distributions. The Fund declared two dividends in 2006 totaling \$2.625 per share. The 2006 dividends were 100% qualifying with \$1.769 per share classified as ordinary income dividends and \$0.856 per share classified as a capital gain distribution.

**Common Stock Repurchases**

On September 16, 2008, the Fund repurchased an aggregate of 423,960 shares of its common stock, representing 4.9% of its outstanding shares, from unaffiliated third parties in a private transaction. In compliance with federal law, the sale was effected at the shares' market price computed as the 5-day volume-weighted average closing price prior to the date of sale, which was September 11, 2008. The shares were repurchased at a discount to the Fund's net asset value and subsequently retired.

There were no common stock repurchases in 2007.

**Subsequent Events**

On January 2, 2009, the Fund sold U.S. Treasury Bills for \$45.0 million and repaid its year-end margin loan.

On February 27, 2009, the Fund announced the declaration of a first quarter dividend of \$0.1075 per share in accordance with the Fund's revised managed distribution policy, pursuant to which it intends to pay 10% of the Fund's market value based on the 2008 year-end closing price of \$4.30. This dividend is payable on March 30, 2009 to shareholders of record as of March 9, 2009. The dividend will be payable in shares of common stock. The classification of this dividend as between ordinary income, capital gain and return of capital will not be known until December 31, 2009, since any purchase or sale of a portfolio company during the remainder of the year will affect the classification.

On March 24, 2009, the Fund announced that it suspended its managed distribution policy and payment of quarterly distributions for an indefinite period, following the distribution of the first quarter dividend to be paid on March 30, 2009.

**Item 7A. Quantitative and Qualitative Information About Market Risk**

The Fund is subject to financial market risks, including changes in interest rates with respect to investments in debt securities and outstanding debt payable, as well as changes in marketable equity security prices. In the

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future, the Fund may invest in companies outside the United States, including in Europe and Asia, which would give rise to exposure to foreign currency value fluctuations. The Fund does not use derivative financial instruments to mitigate any of these risks. The return on investments is generally not affected by foreign currency fluctuations.

The Fund's investments in portfolio securities consist of some fixed-rate debt securities. Since the debt securities are generally priced at a fixed rate, changes in interest rates do not directly affect interest income. In addition, changes in market interest rates are not typically a significant factor in the determination of fair value of these debt securities, since the securities are generally held to maturity. The Fund determines their fair values based on the terms of the relevant debt security and the financial condition of the issuer.

A major portion of the Fund's investment portfolio consists of debt and equity investments in private companies. Modest changes in public market equity prices generally do not significantly impact the estimated fair value of these investments. However, significant changes in market equity prices can have a longer-term effect on valuations of private companies, which could affect the carrying value and the amount and timing of gains or losses realized on these investments. A small portion of the investment portfolio also consists of common stocks in publicly traded companies. These investments are directly exposed to equity price risk, in that a hypothetical ten percent change in these equity prices would result in a similar percentage change in the fair value of these securities.

The Fund is classified as a non-diversified investment company under the Investment Company Act, which means the Fund is not limited in the proportion of its assets that may be invested in the securities of a single user. The value of one segment called Alternative Energy includes one portfolio company and was 27.8% of the net asset value and 31.6% of the Fund's investments in portfolio company securities (at fair value) as of December 31, 2008. Changes in business or industry trends or in the financial condition, results of operations, or the market's assessment of any single portfolio company will affect the net asset value and the market price of the Fund's common stock to a greater extent than would be the case if the Fund were a diversified company holding numerous investments.



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**Item 8. Financial Statements and Supplementary Data**

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and

Stockholders of Equus Total Return, Inc. (formerly Equus II Incorporated):

We have audited the accompanying balance sheets of Equus Total Return, Inc. (a Delaware corporation), including the schedules of portfolio securities, as of December 31, 2008 and 2007 and the related statements of operations, changes in net assets and cash flows for each of the three years ended December 31, 2008 and the selected per share data and ratios for each of the four years ended December 31, 2008. These financial statements and selected per share data and ratios are the responsibility of the management of Equus Total Return, Inc. Our responsibility is to express an opinion on these financial statements and selected per share data and ratios based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We were not engaged to examine management's assertion about the effectiveness of Equus Total Return, Inc.'s internal control over financial reporting as of December 31, 2008 and 2007 included in the accompanying Management's Report on Internal Control Over Financial Reporting and, accordingly, we do not express an opinion thereon.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Equus Total Return, Inc. as of December 31, 2008 and 2007 and the results of its operations and its cash flows for each of the three years ended December 31, 2008 and the selected per share data and ratios for each of the four years ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A to the financial statements, the Fund adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurement* and Statement of Financial Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*.

As discussed in Note 3, the financial statements include investments in portfolio securities valued at (in thousands) \$69,036 and \$72,102 (88.0% and 69.9% of net assets) as of December 31, 2008 and 2007, respectively, whose values have been estimated by the Adviser and approved by the Board of Directors of Equus Total Return, Inc. in the absence of readily ascertainable market values. Those estimated values may differ materially from the values that would have been used had a ready market for the securities existed.

/s/ UHY LLP  
UHY LLP  
Houston, Texas

March 31, 2009

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of

Equus Total Return, Inc. (formerly Equus II Incorporated):

In our opinion, the accompanying selected per share data and ratios present fairly, in all material respects, the financial highlights of Equus Total Return, Inc. (formerly Equus II, Incorporated) (a Delaware corporation) for the one year in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These selected per share data and ratios are the responsibility of the Company's management. Our responsibility is to express an opinion on these selected per share data and ratios based on our audit. We conducted our audit of these selected per share data and ratios in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the selected per share data and ratios are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PRICEWATERHOUSECOOPERS LLP  
PricewaterhouseCoopers LLP  
Houston, TX

March 21, 2005

**Table of Contents****EQUUS TOTAL RETURN, INC.****BALANCE SHEETS****DECEMBER 31, 2008 AND 2007**

(in thousands, except per share amounts)	December 31, 2008	December 31, 2007
<b>Assets</b>		
Investments in portfolio securities at fair value:		
Control investments (cost at \$36,808 and \$23,444 respectively)	\$ 37,190	\$ 25,646
Affiliate investments (cost at \$18,353 and \$14,721 respectively)	20,974	32,111
Non-affiliate investments (cost at \$16,930 and \$17,118 respectively)	10,872	14,345
Total investments in portfolio securities at fair value	69,036	72,102
Restricted cash & temporary investments, at cost which approximates fair value	45,419	30,296
Cash	71	28
Temporary cash investments, at cost which approximates fair value	8,585	30,912
Accounts receivable	8	107
Accrued interest and dividends receivable due from portfolio companies	944	1,023
Escrowed receivables, at fair value		262
Total assets	\$ 124,063	\$ 134,730
<b>Liabilities and net assets</b>		
Liabilities:		
Accounts payable and accrued liabilities	\$ 204	\$ 108
Due to Adviser	455	1,410
Borrowing under margin account	44,969	29,996
Total liabilities	45,628	31,514
Commitments and contingencies		
Net assets:		
Preferred stock, \$.001 par value, 5,000 shares authorized, no shares outstanding		
Common stock, \$.001 par value, 50,000 shares authorized, 8,565 and 8,401 shares outstanding, respectively	9	8
Additional paid-in capital	85,966	89,021
Undistributed net investment losses	(4,485)	(3,772)
Undistributed net capital gains		1,141
Unrealized (depreciation) appreciation of portfolio securities, net	(3,055)	16,818
Total net assets	\$ 78,435	\$ 103,216
Net assets per share	\$ 9.16	\$ 12.29

The accompanying notes are an integral part of these financial statements.

**Table of Contents****EQUUS TOTAL RETURN, INC.****STATEMENTS OF OPERATIONS****FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006**

(in thousands, except per share amounts)	2008	2007	2006
Investment income:			
Interest and dividend income from portfolio securities:			
Control investments	\$ 1,023	\$ 581	\$ 4,179
Affiliate investments	492	768	15
Non-affiliate investments	1,116	1,762	
Total interest and dividend income	2,631	3,111	4,194
Interest from temporary cash investments	550	1,746	1,822
Total investment income	3,181	4,857	6,016
Expenses:			
Management fee	1,861	1,730	1,752
Incentive fee		903	1,956
Professional fees	828	860	1,020
Administrative fees	450	450	450
Director fees and expenses	434	381	441
Mailing, printing and other expenses	259	261	227
Interest expense	49	83	157
Taxes	13	103	115
Offering costs		609	
Total expenses	3,894	5,380	6,118
Net investment loss	(713)	(523)	(102)
Net realized gain (loss) on portfolio securities:			
Control investments	625	1,242	17,803
Affiliate investments	351		564
Non-affiliate investments	(52)	4,022	645
Total net realized gain on portfolio securities	924	5,264	19,012
Net unrealized (depreciation) appreciation of portfolio securities:			
End of period	(3,055)	16,818	9,292
Beginning of period	16,818	9,292	14,043
Net change in unrealized (depreciation) appreciation of portfolio securities	(19,873)	7,526	(4,751)
Net (decrease) increase in net assets resulting from operations	\$ (19,662)	\$ 12,267	\$ 14,159
Net (decrease) increase in net assets resulting from operations per share:			
Basic and diluted	\$ (2.33)	\$ 1.49	\$ 1.78
Weighted average shares outstanding, in thousands			
Basic and diluted	8,429	8,251	7,949

The accompanying notes are an integral part of these financial statements.

**Table of Contents****EQUUS TOTAL RETURN, INC.****STATEMENTS OF CHANGES IN NET ASSETS****FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006**

(in thousands)	2008	2007	2006
<b>(Decrease) increase in net assets from operations</b>			
Net investment loss	\$ (713)	\$ (523)	\$ (102)
Net realized gain on portfolio securities	924	5,264	19,012
Net change in unrealized (depreciation) appreciation of portfolio securities	(19,873)	7,526	(4,751)
<b>Net increase (decrease) in net assets resulting from operations</b>	<b>(19,662)</b>	<b>12,267</b>	<b>14,159</b>
<b>Distributions to stockholders</b>			
Distributions of realized gains	(2,065)	(4,123)	(9,254)
Return of capital distribution	(3,267)		(10,200)
<b>Net decrease in net assets resulting from stockholder distributions</b>	<b>(5,332)</b>	<b>(4,123)</b>	<b>(19,454)</b>
<b>Capital share transactions:</b>			
Shares issued in lieu of cash dividend	3,223	1,836	5,929
Repurchase of common stock	(3,010)		
<b>Decrease in net assets resulting from capital share transactions</b>	<b>213</b>	<b>1,836</b>	<b>5,929</b>
<b>Decrease in net assets</b>	<b>(24,781)</b>	<b>9,980</b>	<b>634</b>
<b>Net assets at beginning of period</b>	<b>103,216</b>	<b>93,236</b>	<b>92,602</b>
<b>Net assets at end of period</b>	<b>\$ 78,435</b>	<b>\$ 103,216</b>	<b>\$ 93,236</b>

The accompanying notes are an integral part of these financial statements.

**Table of Contents****EQUUS TOTAL RETURN, INC.****STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006**

(in thousands)	2008	2007	2006
Reconciliation of (decrease) increase in net assets resulting from operations to net cash (used in) provided by operating activities:			
Net (decrease) increase in net assets resulting from operations	\$ (19,662)	\$ 12,267	\$ 14,159
Adjustments to reconcile (decrease) increase in net assets resulting from operations to net cash (used in) provided by operating activities:			
Net realized gain on dispositions of portfolio securities	(924)	(5,264)	(19,012)
Net change in unrealized (depreciation) appreciation of portfolio securities	19,873	(7,526)	4,751
Amortization of original issue discount and origination fees	165	92	196
Change in operating assets and liabilities:			
Purchase of portfolio securities	(19,113)	(27,469)	(9,860)
Proceeds from dispositions of portfolio securities	3,861	6,823	44,029
Principal payments from portfolio securities		4,697	3,852
Purchases of restricted cash and temporary investments	(15,123)	(18)	20,167
Decrease (increase) in accounts receivable	99	40	(97)
Increase in accrued interest and dividends receivable due from portfolio securities	(717)	(1,323)	(1,474)
Decrease in deferred offering costs		609	
Decrease (increase) in escrowed receivables	262	(59)	2,004
Increase (decrease) in accounts payable and accrued liabilities	96	(121)	(69)
(Decrease) increase in due to adviser	(955)	(1,012)	1,284
Net cash (used in) provided by operating activities	\$ (32,138)	\$ (18,264)	\$ 59,930
Cash flows from financing activities:			
Borrowings under margin account	185,960	89,957	129,868
Repayments under margin account	(170,987)	(89,940)	(149,835)
Dividends paid	(2,109)	(2,287)	(13,525)
Repurchase of common stock	(3,010)		
Cash paid for deferred offering costs		(25)	(584)
Net cash provided by (used in) financing activities	9,854	(2,295)	(34,076)
Net (decrease) increase in cash and cash equivalents	(22,284)	(20,559)	25,854
Cash and cash equivalents at beginning of period	30,940	51,499	25,645
Cash and cash equivalents at end of period	\$ 8,656	\$ 30,940	\$ 51,499
Non-cash financing activities:			
Shares issued in lieu of cash dividend	\$ 3,223	\$ 1,836	\$ 5,929
Accrued interest or dividends exchanged for portfolio securities	\$ 796	\$ 828	\$ 1,448
Supplemental disclosure of cash flow information:			
Interest paid	\$ 32	\$ 106	\$ 153
Income taxes paid	\$ 13	\$ 85	\$ 115

The accompanying notes are an integral part of these financial statements.



**Table of Contents****EQUUS TOTAL RETURN, INC.****SELECTED PER SHARE DATA AND RATIOS****FOR THE FIVE YEARS ENDED DECEMBER 31, 2008**

	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Investment income	\$ 0.38	\$ 0.59	\$ 0.76	\$ 0.36	\$ 0.96
Expenses	0.46	0.65	0.77	0.81	0.39
Net investment (loss) income	(0.08)	(0.06)	(0.01)	(0.45)	0.57
Net realized gain (loss) on portfolio securities	0.11	0.64	2.39	0.18	(0.84)
Net change in unrealized appreciation of portfolio securities	(2.36)	0.91	(0.60)	2.68	0.46
Net (decrease) increase in net assets resulting from operations	(2.33)	1.49	1.78	2.41	0.19
<b>Capital transactions:</b>					
Officers' notes settlement					0.10
Dividend declared	(0.63)	(0.50)	(2.63)		(0.57)
Share repurchase	0.36				0.18
Dilutive effect of shares issued in common stock dividend	(0.53)	(0.12)	(0.28)	(0.40)	(0.17)
Decrease in net assets resulting from capital transactions	(0.80)	(0.62)	(2.91)	(0.40)	(0.46)
Net decrease in net assets	(3.13)	0.87	(1.13)	2.01	(0.27)
Net assets at beginning of period	12.29	11.42	12.55	10.54	10.81
Net assets at end of period, basic and diluted	\$ 9.16	\$ 12.29	\$ 11.42	\$ 12.55	\$ 10.54
Weighted average number of shares outstanding during period, in thousands	8,429	8,251	7,949	6,948	6,462
Market value per share at end of period	\$ 4.30	\$ 6.31	\$ 8.54	\$ 8.93	\$ 7.71
<b>Selected ratios:</b>					
Ratio of expenses to average net assets	4.29%	5.48%	6.58%	7.03%	3.55%
Ratio of net investment loss to average net assets	(0.79)%	(0.53)%	(0.11)%	(3.89)%	5.29%
Ratio of net increase in net assets resulting from operations to average net assets	(21.65)%	12.49%	15.24%	20.74%	1.76%
Total return on market price*	(21.84)%	(20.26)%	25.08%	15.82%	2.90%

\* Adjusted for dividends and can be calculated as the December 31, 2008 market value plus year-to-date dividends declared less December 31, 2007 market value, divided by December 31, 2007 market value.

The accompanying notes are an integral part of these financial statements.

**Table of Contents****EQUUS TOTAL RETURN, INC.****SCHEDULE OF PORTFOLIO SECURITIES****DECEMBER 31, 2008**

<b>Name and Location of Portfolio Company</b>	<b>Industry</b>	<b>Date of Initial Investment(4)</b>	<b>Investment</b>	<b>Principal</b>	<b>Cost of Investment</b>	<b>Fair Value(3)</b>
<i>(amounts in thousands)</i>						
<b>Control investments: Majority-owned(7):</b>						
Equus Media Development Company, LLC Houston, TX	Media	January 2007	Member interest (100%)		\$5,000	\$5,000
Riptide Entertainment, LLC Miami, FL	Entertainment and leisure	December 2005	Member interest (64.67%) 8% promissory notes	\$9,560	65 9,560	7,437
Sovereign Business Forms, Inc.(8) Houston, TX	Business products and services	August 1996	1,214,630 shares of common stock(1) 12% promissory notes(1)	3,250	5,080 3,250	4,800 3,250
Spectrum Management, LLC Carrollton, TX	Business products and services	December 1999	285,000 units of Class A member interest 16% subordinated promissory note(1)	1,690	2,850 1,690	6,419 1,690
<b>Total Control investments: Majority-owned (represents 41.4% of total investments at fair value)</b>					<b>\$27,495</b>	<b>\$28,596</b>
<b>Control Investments: Non-majority owned(6):</b>						
ConGlobal Industries Holding, Inc. San Ramon, CA	Shipping products and services	February 1997	24,397,303 shares of common stock 7% promissory note Member interest in CCI-ANI Finance, LLC Member interest (66.7%) in JL Madre, LLC(1)	3,570	\$1,370 3,570 2,734 865	\$790 3,570 2,989 936
HealthSPAC, LLC El Segundo, CA	Healthcare	December 2006	Member interest (40%) 12% promissory note	734	40 734	40 269
<b>Total Control Investments: Non-majority Owned (represents 12.5% of total investments at fair value)</b>					<b>\$9,313</b>	<b>8,594</b>
<b>Total Control Investments: (represents 53.9% of total investments at fair value)</b>					<b>\$36,808</b>	<b>37,190</b>
<b>Affiliate Investments(5):</b>						
Infinia Corporation Kennewick, WA	Alternative energy	June 2007	666,667 Class A shares preferred stock 160,720 Class B shares preferred stock Option to purchase 16,000 shares of common stock at \$6.35 per share through December 19, 2012		\$3,000 5,000	\$14,973 5,000 336

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Nickent Golf, Inc. City of Industry, CA	Entertainment and leisure	June 2007	13% promissory note 3,000,000 shares Class A Convertible preferred stock Warrants to buy 15,000 shares of common stock at \$1 per share through March 17, 2013 Warrants to buy 600,815 shares of common stock at \$1.00 per share through August 16, 2010, warrant terms subject to change	\$6,430	6,430 3,000	180
PalletOne, Inc. Bartow, FL	Shipping products and services	October 2001	350,000 shares of common stock		350	
RP&C International Investments LLC New York, NY	Healthcare	September 2006	Member interest (17.2%)		573	485
<b>Total Affiliate Investments (represents 30.4% of total investments at fair value)</b>					<b>\$18,353</b>	<b>\$20,974</b>

**Table of Contents****EQUUS TOTAL RETURN, INC.****SCHEDULE OF PORTFOLIO SECURITIES (Continued)****DECEMBER 31, 2008**

<b>Name and Location of Portfolio Company</b>	<b>Industry</b>	<b>Date of Initial Investment(4)</b>	<b>Investment</b>	<b>Principal</b>	<b>Cost of Investment</b>	<b>Fair Value(3)</b>
<b>Non-Affiliate Investments (less than 5% owned):</b>						
<i>(amounts in thousands)</i>						
1848 Capital Partners LLC Miami, FL	Entertainment and leisure	January 2008	18% promissory note(1)(2)	\$3,135	\$3,135	\$3,135
Big Apple Entertainment Partners LLC New York, NY	Entertainment and leisure	October 2007	18% promissory note(1)	3,000	3,000	3,000
Creekstone Florida Holdings, LLC Houston, TX	Real estate	December 2005	17-19.8% subordinated promissory note	4,000	4,000	
London Bridge Entertainment Partners LLC New York, NY	Entertainment and leisure	August 2008	18% promissory note(1)	2,500	2,500	2,500
Metic Group, PLC London, UK	Commercial building products	August 2008	1,830,660 shares common of stock(2)		1,000	737
The Bradshaw Group Richardson, TX	Business products and services	May 2000	726,806 Class B Shares 12.25% preferred stock 38,750 Class C shares preferred stock 1,042,988 Class D shares 15% preferred stock 2,587,203 Class E shares 8% preferred stock Warrant to buy 2,229,450 shares of common stock through May 2016		1,795	
Trulite, Inc.	Alternative energy	August 2008	15% promissory note(1)	1,500	1,500	1,500

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Houston, TX

<b>Total Non-Affiliate Investments (represents 15.7% of total investments at fair value)</b>	<b>\$16,930</b>	<b>\$10,872</b>
<b>Total Investments</b>	<b>\$72,091</b>	<b>\$69,036</b>

- (1) Income-producing. All other securities are considered non-income producing.
- (2) Income on these securities is paid-in-kind by the issuance of additional securities or through accretion of original issue discount.
- (3) See Business Valuation.
- (4) Investments subsequent to June 30, 2005 were selected by the Adviser.
- (5) Affiliate investments are generally defined under the Investment Company Act of 1940 as companies in which the Fund owns at least 5% but not more than 25% voting securities of the company.
- (6) Non-majority owned control investments are generally defined under the Investment Company Act of 1940 as companies in which the Fund owns more than 25% but not more than 50% of the voting securities of the company.
- (7) Majority owned investments are generally defined under the Investment Company Act of 1940 as companies in which the Fund owns more than 50% of the voting securities of the company.
- (8) In May 2008, Sovereign restructured its ownership and debt. As a result, the Fund's ownership interest increased to majority-owned control investment.

The accompanying notes are an integral part of these financial statements.

**Table of Contents****EQUUS TOTAL RETURN, INC.****SCHEDULE OF PORTFOLIO SECURITIES (Continued)****DECEMBER 31, 2008**

Substantially all of the Fund's portfolio securities are restricted from public sale without prior registration under the Securities Act of 1933. The Fund negotiates certain aspects of the method and timing of the disposition of the Fund's investment in each portfolio company, including registration rights and related costs.

As defined in the Investment Company Act of 1940, all of the Fund's investments are in eligible portfolio companies. The Fund provides significant managerial assistance to all of the portfolio companies in which it has invested. The Fund provides significant managerial assistance to portfolio companies that comprise 88.0% of the total value of the investments in portfolio securities as of December 31, 2008.

The Fund's investments in portfolio securities consist of the following types of securities at December 31, 2008 (in thousands):

<b>Type of Securities</b>	<b>Cost</b>	<b>Fair Value</b>	<b>Fair Value as Percentage of Net Assets</b>
Secured and subordinated debt	\$ 39,369	\$ 26,531	33.8%
Preferred stock	12,795	19,973	25.5%
Limited liability company investments	12,127	15,869	20.2%
Common stock	7,800	6,327	8.1%
Options and warrants		336	0.4%
Total	\$ 72,091	\$ 69,036	88.0%

Two notes receivable included in secured and subordinated debt with an estimated fair value of \$3.1 million provide that all or a portion interest is paid-in-kind or the original issue discount is accreted over the life of the notes, by adding such amount to the principal of the notes. For the remainder of secured and subordinated debt, cash payments of interest are currently being received on notes aggregating \$12.1 million in fair value, while no cash payments are being received for notes totaling \$11.3 million.

The following is a summary by industry of the Fund's investments as of December 31, 2008 (in thousands):

<b>Industry</b>	<b>Fair Value</b>	<b>Fair Value as Percentage of Net Assets</b>
Alternative energy	\$ 21,809	27.8%
Entertainment and leisure	16,252	20.7%
Business products and services	16,159	20.6%
Shipping products and services	8,285	10.6%
Media	5,000	6.4%
Healthcare	794	1.0%
Commercial building products	737	0.9%
Real estate		0.0%
Total	\$ 69,036	88.0%

The accompanying notes are an integral part of these financial statements.



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**EQUUS TOTAL RETURN, INC.**  
**SCHEDULE OF PORTFOLIO SECURITIES**  
**DECEMBER 31, 2007**

Name and Location of Portfolio Company	Industry	Date of Initial Investment(4)	Type of Securities	Principal	Cost of Investment	Fair Value(3)
				<i>(amounts in thousands)</i>		
<b>Control Investments: Majority-owned(7):</b>						
Equus Media Development Company, LLC Houston, TX	Media	January 2007	Member interest (100%)		5,000	5,000
Riptide Entertainment, LLC Miami, FL	Entertainment and leisure	December 2005	Member interest (64.67%)  8% promissory notes		65 4,835	65 4,835
Spectrum Management, LLC Carrollton, TX	Business products and services	December 1999	285,000 units of Class A member  interest 16% subordinated promissory  note(1)(2)		2,850 1,690	8,381 1,690
<b>Total Control Investments: Majority-owned (represents 27.7% of total investments at fair value)</b>					<b>\$14,440</b>	<b>\$19,971</b>
<b>Control Investments: Non-majority-owned(6):</b>						
ConGlobal Industries Holding, Inc. Houston, TX	Shipping products and services	February 1997	24,397,303 shares of common stock 7% promissory note(2) Member interest in CCI-ANI Finance, LLC(2) Member interest (66.7%) in JL Madre, LLC(1) Member interest (28.3%) in JL  Madre Equipment, LLC(1)		1,370 3,266 2,734 1,000 69	2,153 1,803 1,035 119
HealthSPAC, LLC El Segundo, CA	Healthcare	December 2006	Member interest (40%)  12% promissory note		40 525	40 525
<b>Total Control Investments: Non-majority-owned (represents 7.9% of total investments at fair value)</b>					<b>\$9,004</b>	<b>\$5,675</b>
<b>Total Control Investments: (represents 35.6% of total investments at fair value)</b>					<b>\$23,444</b>	<b>\$25,646</b>



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**Affiliate Investments(5):**

Infinia Corporation	Alternative energy	June 2007	666,667 Class A Shares preferred stock	3,000	20,740
Kennewick, WA					
Nickent Golf, Inc.	Entertainment and leisure	June 2007	13% promissory note(1)(2)	6,066	6,066
City of Industry, CA			2,000,000 shares Class A convertible preferred stock Warrants to buy 463,917 shares of common stock at \$0.97 per share through August 4, 2009, warrant terms subject to change	2,000	2,000
PalletOne, Inc.	Shipping products and services	October 2001	350,000 shares of common stock	350	
South Bartow, FL					
RP&C International Investments LLC New York, NY	Healthcare	September 2006	Membership interest (17.2%)	3,305	3,305
<b>Total Affiliate Investments (represents 44.5% of total investments at fair value)</b>				<b>\$14,721</b>	<b>\$32,111</b>

The accompanying notes are an integral part of these financial statements.

**Table of Contents****EQUUS TOTAL RETURN, INC.****SCHEDULE OF PORTFOLIO SECURITIES (Continued)****DECEMBER 31, 2007**

<b>Name and Location of Portfolio Company</b>	<b>Industry</b>	<b>Date of Initial Investment(4)</b>	<b>Type of Securities</b>	<b>Cost of Principal Investment(3)</b>	<b>Fair Value(3)</b>
<b>Non-Affiliate Investments (less than 5% owned)</b>					
Big Apple Entertainment	Entertainment and leisure	October 2007	Promissory note(1)	\$ 3,000	\$ 3,000
Partners LLC					
New York, NY					
The Bradshaw Group	Business products and services	May 2000	726,806 Class B Shares 12.25% preferred stock	1,795	485
Richardson, TX			38,750 Class C shares preferred stock 788,649 Class D shares 15% preferred stock 2,218,109 Class E shares 8% preferred stock Warrant to buy 2,229,450 shares of common stock through May 2008		
Creekstone Florida	Real estate	December 2005	17-19.8% subordinated promissory note(1)(2)	\$ 4,000	\$ 4,166
Holdings, LLC					
Houston, TX					
Sovereign Business Forms, Inc.	Business products and services	August 1996	29,854 shares of preferred stock(1)(2) 15% promissory notes(1)(2)	2,985 5,172	1,522 5,172
Houston, TX			Warrant to buy 551,894 shares of common stock at \$1 per share through Aug 2008 Warrant to buy 25,070 shares of common stock at \$1.25 per share through Aug 2008 Warrant to buy 273,450 shares of common stock at \$1 per share through Oct 2009		
<b>Total Non-Affiliate Investments (represents 19.9% of total investments at fair value)</b>				<b>\$ 17,118</b>	<b>\$ 14,345</b>
<b>Total Investments</b>				<b>\$ 55,283</b>	<b>\$ 72,102</b>

(1) Income-producing. All other securities are considered non-income producing.

(2) Income on these securities is paid-in-kind by the issuance of additional securities or through accretion of original issue discount.

(3) See Business Valuation.

(4) Investments subsequent to June 30, 2005 were selected by the Adviser.

(5)

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Affiliate investments are generally defined under the Investment Company Act of 1940 as companies in which the Fund owns at least 5% but not more than 25% voting securities of the company.

- (6) Non-majority owned control investments are generally defined under the Investment Company Act of 1940 as companies in which the Fund owns more than 25% but not more than 50% of the voting securities of the company.
- (7) Majority owned investments are generally defined under the Investment Company Act of 1940 as companies in which the Fund owns more than 50% of the voting securities of the company.

The accompanying notes are an integral part of these financial statements.

**Table of Contents****EQUUS TOTAL RETURN, INC.****SCHEDULE OF PORTFOLIO SECURITIES (Continued)****DECEMBER 31, 2007**

Substantially all of the Fund's portfolio securities are restricted from public sale without prior registration under the Securities Act of 1933. The Fund negotiates certain aspects of the method and timing of the disposition of the Fund's investment in each portfolio company, including registration rights and related costs.

As defined in the Investment Company Act of 1940, all of the Fund's investments are in eligible portfolio companies. The Fund provides significant managerial assistance to all of the portfolio companies in which it has invested. The Fund provides significant managerial assistance to portfolio companies that comprise 96% of the total value of the investments in portfolio securities as of December 31, 2007.

The Fund's investments in portfolio securities consist of the following types of securities at December 31, 2007 (in thousands):

<b>Type of Securities</b>	<b>Cost</b>	<b>Fair Value</b>	<b>Fair Value as Percentage of Net Assets</b>
Secured and subordinated debt	\$ 28,195	\$ 27,083	26.3%
Preferred stock	9,780	24,747	24.0%
Limited liability company	15,588	20,272	19.6%
Common stock	1,720		0.0%
Options and warrants			0.0%
Total	\$ 55,283	\$ 72,102	69.9%

Six notes receivable included in secured and subordinated debt with an estimated fair value of \$19.3 million provided that all or a portion of interest is paid-in-kind or the original issue discount is accreted over the life of the notes, by adding such amount to the principal of the notes. For the remainder of secured and subordinated debt, cash payments of interest are being made currently on notes aggregating \$3.0 million in fair value, while no cash payments are being received for notes totaling \$4.8 million.

The following is a summary by industry of the Fund's investments as of December 31, 2007 (in thousands):

<b>Industry</b>	<b>Fair Value</b>	<b>Fair Value as Percentage of Net Assets</b>
Alternative energy	\$ 20,740	20.1%
Business products and services	17,250	16.7%
Entertainment and leisure	15,966	15.5%
Shipping products and services	5,110	5.0%
Media	5,000	4.8%
Real estate	4,166	4.0%
Healthcare	3,870	3.7%
Total	\$ 72,102	69.9%

The accompanying notes are an integral part of these financial statements.



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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**DECEMBER 31, 2008, 2007 AND 2006**

**(1) ORGANIZATION AND BUSINESS PURPOSE**

Equus Total Return, Inc. (the Fund, EQS), formerly Equus II Incorporated, a Delaware corporation, was formed by Equus Investments II, L.P. (the Partnership) on August 16, 1991. On July 1, 1992, the Partnership was reorganized and all of the assets and liabilities of the Partnership were transferred to the Fund in exchange for shares of common stock of the Fund. The shares of the Fund trade on the New York Stock Exchange under the symbol EQS. On August 11, 2006, shareholders of the Fund approved the change of the Fund's investment strategy to a total return investment objective. This new strategy seeks to provide the highest total return, consisting of capital appreciation and current income. In connection with this strategic investment change, the shareholders also approved the change of name from Equus II Incorporated to Equus Total Return, Inc.

The Fund seeks to achieve capital appreciation by making investments in equity and equity-oriented securities issued by privately-owned companies in transactions negotiated directly with such companies. The Fund seeks to invest primarily in companies which intend to grow either by acquiring other businesses, including leveraged buyouts, or internally. The Fund may also invest in recapitalizations of existing businesses or special situations from time to time. The Fund's investments in portfolio companies consist principally of equity securities such as common and preferred stock, but also include other equity-oriented securities such as debt convertible into common or preferred stock or debt combined with warrants, options or other rights to acquire common or preferred stock. The Fund elected to be treated as a business development company under the Investment Company Act of 1940 (1940 Act). For tax purposes, the Fund has elected to be treated as a regulated investment company (RIC). With shareholder approval on June 30, 2005, the Fund has entered into a new investment advisory agreement with Moore Clayton Capital Advisors, Inc. (the Adviser). Prior to this agreement, the Fund's adviser was Equus Capital Management Corporation.

The Fund elected to retain the Adviser in part to provide the Fund with enhanced investment opportunities in both the United States and internationally. Effective August 11, 2006, the Fund began to employ a total return investment style. The total return style combines both growth and income investments and is intended to strike a balance between the potential for gain and the risk of loss. In the growth category, the Fund is a growth-at-reasonable-price investor. The Fund invests primarily in privately owned companies and is open to virtually any potential growth investment in the privately owned arena. However, the Fund's primary aim is to identify and acquire only those equity securities that meet its criteria for selling at reasonable prices. The income investments made by the Fund consist principally of purchasing debt financing with the objective of generating regular interest income back to the fund as well as long-term capital appreciation through the exercise and sale of warrants received in connection with the financing.

The Fund has decided to further the total return investment objective, with authorization from the Board of Directors (which includes all of the Fund's independent directors) and approval of a majority of the shareholders, by amending the Fund's Restated Certificate of Incorporation to change the name of the Fund from Equus II Incorporated to Equus Total Return, Inc. This proposal was approved by a majority of the shareholders on August 11, 2006.

**(2) LIQUIDITY AND FINANCING ARRANGEMENTS**

**Liquidity and Revolving Line of Credit** There are several factors that may materially affect the Fund's liquidity during the reasonably foreseeable future. The Fund views this period as the twelve month period from the date of the financial statements in this Form 10-K, *i.e.*, the period through December 31, 2009.

Management is currently evaluating the impact of current market conditions on its portfolio company valuations and their ability to provide current income. Management has followed valuation techniques in a

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**DECEMBER 31, 2008, 2007 AND 2006**

consistent manner; however, it is cognizant of current market conditions that might effect future valuations of portfolio securities. If necessary to meet the Fund's investment commitments of \$4.2 million, the Fund has a secured \$7.5 million revolving line of credit facility with Amegy Bank. The Fund has not yet borrowed under this facility. The Fund believes that its operating cash flow and cash on hand will be sufficient to meet operating requirements and to finance routine capital expenditures through the next twelve months.

As of December 31, 2008, the Fund had cash and temporary cash investments of \$8.7 million. The Fund had \$69.0 million of its net assets of \$78.4 million invested in portfolio securities. Restricted assets totaled \$45.4 million, of which \$45.0 million were invested in U.S. Treasury Bills for the purpose of satisfying the diversification requirement to maintain the Fund's pass-through tax treatment and \$0.4 million for the required 1% brokerage deposit. These securities are held by a securities brokerage firm and are pledged along with cash to secure the payment of the margin account balance. The U.S. Treasury bills matured and the margin loan was repaid to the brokerage firm on January 2, 2009.

As of December 31, 2007, the Fund had cash and temporary cash investments of \$30.9 million. The Fund had \$72.1 million of its net assets of \$103.2 million invested in portfolio securities. Restricted assets totaled \$30.3, of which \$30.0 million were invested in U.S. Treasury Bills for the purpose of satisfying the diversification requirement to maintain the Fund's pass-through tax treatment and \$0.3 million for the required 1% brokerage deposit. These securities are held by a securities brokerage firm and are pledged along with cash to secure the payment of the margin account balance. The U.S. Treasury bills were sold and the margin loan was repaid to the brokerage firm on January 2, 2008.

On August 13, 2008, the Fund entered into a \$7.5 million revolving line of credit agreement (the "Credit Facility") with Amegy Bank. The Fund can borrow up to \$7.5 million under the Credit Facility, subject to a borrowing base equal to 20% of the value of the Fund's eligible portfolio assets. The Credit Facility bears a floating interest rate of the higher of (a) the Federal Funds Rate plus 1/2 of 1% and (b) the rate of interest in effect for such day as publicly announced from time to time by Lender as its "prime rate". The Credit Facility is secured by substantially all of the Fund's portfolio assets and securities. It contains certain restrictive covenants, including, but not limited to, the maintenance of certain financial ratios and certain limitations on indebtedness, liens, sales of assets, mergers and transactions with affiliates all of which the Fund is in compliance as of December 31, 2008. To date, the Fund has not borrowed any amounts under the Credit Facility.

As of December 31, 2008, the Fund had total commitments of \$4.2 million with \$1.0 million, \$3.2 million committed to RP&C and HealthSPAC, respectively, which are both in the healthcare sector.

**RIC Borrowings and Restricted Temporary Cash Investments** During 2008 and 2007, the Fund borrowed sufficient funds to maintain the Fund's RIC status by utilizing a margin account with a securities brokerage firm. There is no assurance that such arrangement will be available in the future. If the Fund is unable to borrow funds to make qualifying investments, it may no longer qualify as a RIC. The Fund would then be subject to corporate income tax on the Fund's net investment income and realized capital gains, and distributions to stockholders would be subject to income tax as ordinary dividends. Failure to continue to qualify as a RIC could be material to us and the Fund's stockholders.

At December 31, 2008, the Fund borrowed \$45.0 million to make qualifying investments to maintain its RIC status by utilizing a margin account with a securities brokerage firm. The Fund collateralized such borrowings with restricted cash and temporary investments in U.S. Treasury bills of \$45.4 million. The U.S Treasury bills were sold on January 2, 2009 and the total amount borrowed was repaid at that time.

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**DECEMBER 31, 2008, 2007 AND 2006**

At December 31, 2007, the Fund borrowed \$30.0 million to make qualifying investments to maintain its RIC status by utilizing a margin account with a securities brokerage firm. The Fund collateralized such borrowings with restricted cash and temporary investments in U.S. Treasury bills of \$30.3 million. The U.S. Treasury bills matured and the total amount borrowed was repaid on January 3, 2008.

**Certain Risks and Uncertainties** Economic conditions during 2008 and market dislocations resulted in the availability of debt and equity capital declining significantly. Generally, the limited amount of available debt financing has shorter maturities, higher interest rates and fees, and more restrictive terms than debt facilities available in the past. In addition, during 2008 the price of our common stock fell well below our net asset value, thereby making it undesirable to issue additional shares of our common stock. Because of these challenges, our near-term strategies shifted from originating debt and equity investments, to deleveraging our balance sheet, and preserving liquidity necessary to meet our operational needs. Key initiatives that we undertook during 2008 to provide necessary liquidity include monetizations, the suspension of dividends and the renegotiation of our debt agreements. Although there can be no assurances that such initiatives will be sufficient, we believe we have sufficient liquidity to meet our 2009 operating requirements.

**(3) SIGNIFICANT ACCOUNTING POLICIES**

The following is a summary of significant accounting policies followed by the Fund in the preparation of its financial statements:

**Use of Estimates** The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Although management believes the estimates and assumptions used in preparing these interim financial statements and related notes are reasonable in light of known facts and circumstances, actual results could differ from those estimates.

**Valuation of Investments** Portfolio investments are carried at fair value with the net change in unrealized appreciation or depreciation included in the determination of net assets. Valuations of portfolio securities are performed in accordance with accounting principles generally accepted in the United States of America and the financial reporting policies of the Securities and Exchange Commission ( "SEC" ). The applicable methods prescribed by such principles and policies are described below:

*Publicly-traded portfolio securities* Investments in companies whose securities are publicly traded are generally valued at their quoted market price at the close of business on the valuation date.

*Privately-held portfolio securities* The fair value of investments for which no market exists is determined on the basis of procedures established in good faith by the Board of Directors of the Fund. As a general principle, the current fair value of an investment would be the amount the Fund might reasonably expect to receive for it upon its current sale, in an orderly manner. Fair valuations are necessarily subjective and the Adviser's estimate of values may differ materially from amounts actually received upon the disposition of portfolio securities.

Generally, cost is the primary factor used to determine fair value until significant developments affecting the portfolio company (such as results of operations or changes in general market conditions) provide a basis for use of an appraisal valuation. Appraised values are determined quarterly by the Adviser, subject to the approval of the Board of Directors. Appraisal valuations are based upon such factors as a portfolio company's earnings, cash



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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**DECEMBER 31, 2008, 2007 AND 2006**

flow and net worth, the market prices for similar securities of comparable companies, an assessment of the company's current and future financial prospects, any data from third-party valuation firms, and various other factors and assumptions. In the case of unsuccessful operations, the appraisal may be based upon liquidation value.

Most of the Fund's common equity investments of privately held companies are appraised at a multiple of free cash flow generated by the company in its most recent fiscal year, less outstanding funded indebtedness and other senior securities such as preferred stock. Projections of current year free cash flow may be utilized and adjustments for non-recurring items are considered. Multiples utilized are estimated based on the Adviser's experience in the private company marketplace, and are necessarily subjective in nature.

From time to time, portfolio companies are in default of certain covenants in their loan agreements. When the Adviser has a reasonable belief that the portfolio company will be able to restructure the loan agreements to adjust for any defaults, the portfolio company's securities continue to be valued assuming that the company is a going concern. In the event a portfolio company cannot generate adequate cash flow to meet the principal and interest payments on such indebtedness or is not successful in refinancing the debt upon its maturity, the Fund's investment could be reduced or eliminated through foreclosure on the portfolio company's assets or the portfolio company's reorganization or bankruptcy.

The Fund may also use, when available, third-party transactions in a portfolio company's securities as the basis of valuation (the private market method). The private market method will be used only with respect to completed transactions or firm offers made by sophisticated, independent investors.

For valuation purposes, the Fund uses the income approach to value its debt instruments. Since the Fund's general intent is to hold its loans to maturity, the fair value will not exceed the cost of the investment. A change in the assumptions that the Fund uses to estimate the fair value of its debt securities using the yield analysis could have a material impact on the determination of fair value. If there is deterioration in credit quality or a debt security is in workout status, the Fund may consider other factors in determining the fair value of the debt security, including the fair value attributable to the debt security from the enterprise value of the portfolio company or the proceeds that would be received in a liquidation analysis. The Fund's general intent is to hold its debt investments to maturity. Accordingly, the fair value of the debt investments will not exceed the cost of the investment. Certificates of deposit purchased by the Fund generally will be valued at their face value, plus interest accrued to the date of valuation.

The Audit Committee of the Board may engage independent, third-party valuation firms to conduct independent appraisals and review management's preliminary valuations in order to make their own independent assessment of each privately-held investment that the Fund (a) has held for more than one year and (b) holds on its books at a fair value of at least \$2.0 million. The Audit Committee will review and evaluate the preliminary valuations of management and those of any third-party valuation firms, if so retained, and will review and evaluate any third-party firm supplements to reflect any comments from management and/or Audit Committee members. Any third-party valuation data would be considered as one of many factors in a fair value determination. The Audit Committee then would recommend to the full Board fair values for all privately-held securities based on all relevant factors.

Because of the inherent uncertainty of the valuation of portfolio securities which do not have readily ascertainable market values, amounting to \$69.0 million and \$72.1 million as of December 31, 2008 and 2007, respectively, the Fund's fair value determinations may materially differ from the values that would have been

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**DECEMBER 31, 2008, 2007 AND 2006**

used had a ready market existed for the securities. As of December 31, 2008, one of the Fund's portfolio securities, Metic Group plc, was publicly listed on the AIM. There were no publicly traded securities as of December 31, 2007. Fair values do not reflect brokers' fees or other normal selling costs which might become payable on disposition of such investments.

On a daily basis, the Fund adjusts its net asset value for the changes in the value of its publicly held securities and material changes in the value of its private securities and reports those amounts to Lipper Analytical Services, Inc. Weekly and daily net asset values appear in various publications, including Barron's and The Wall Street Journal.

**Deferred Offering Costs** Accumulation of costs related to the offering whereby the Fund would have sold additional shares or rights to acquire shares at a market price that may have been below net asset value. The main components of the costs are legal fees and consultant's fees specifically related to the offering.

Offering costs of \$0.6 million were expensed during the third quarter of 2007 as the Fund abandoned the shareholders' proposal authorizing the Fund to offer and sell, or to issue rights to acquire shares of its common stock at a price below the net asset value of such stock.

**Escrowed Receivables, at Estimated Fair Value** In May of 2007, the Fund sold its interest in The Drilltec Corporation ( Drilltec ). A portion of the proceeds from the sale was placed in a cash escrow account to secure the representations and warranties made to the respective purchasers. As of December 31, 2007, the amount receivable from the Drilltec escrow is valued at \$0.3 million. The Fund received final payment from The Drilltec Corporation escrow account in May 2008.

In February of 2007, the Fund received \$0.1 million from Doane PetCare Enterprises, Inc. ( Doane ). The Fund booked the \$0.1 million as an escrow receivable as of December 31, 2006. This Doane payment is expected to be the final payment from escrow for the sale of Doane, which was sold in October of 2005. As of December 31, 2006, the amount receivable from the Alenco escrow is valued at \$0.1 million. The Fund received payment in full for the escrow in May 2007.

**Investment Transactions** Investment transactions are recorded on the accrual method. Realized gains and losses on investments sold are computed on a specific identification basis.

The Fund classifies its investments in accordance with the requirements of the 1940 Act. Under the 1940 Act, Control Investments are defined as investments in companies in which EQS owns more than 25% of the voting securities or maintains greater than 50% of the board representation. Under the 1940 Act, Affiliate Investments are defined as those non-control investments in companies in which EQS owns between 5% and 25% of the voting securities. Under the 1940 Act, Non-affiliate Investments are defined as investments that are neither Control Investments nor Affiliate Investments.

**Interest Income Recognition** The Fund records interest income, adjusted for amortization of premium and accretion of discount, on an accrual basis to the extent that it expects to collect such amounts. The Fund stops accruing interest on investments when it determines that interest is no longer collectible. If the Fund receives any cash after determining that interest is no longer collectible, it treats such cash as payment on the principal balance until the entire principal balance has been repaid, before it recognizes any additional interest income. The Fund accretes or amortizes discounts and premiums on securities purchased over the life of the respective security using the effective yield method. The amortized cost of investments represents the original cost adjusted for the accretion of discount and/or amortization of premium on debt securities.

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**DECEMBER 31, 2008, 2007 AND 2006**

**Payment in Kind Interest** The Fund has loans in its portfolio that may pay PIK interest. The Fund adds PIK interest, if any, computed at the contractual rate specified in each loan agreement, to the principal balance of the loan and recorded as interest income. To maintain its status as a RIC, the Fund must pay out to stockholders this non-cash source of income in the form of dividends even if it has not yet collected any cash in respect of such investments.

**Cash Flows** For purposes of the Statements of Cash Flows, the Fund considers all highly liquid temporary cash investments purchased with an original maturity of three months or less to be cash equivalents. The Fund includes its investing activities within cash flows from operations. The Fund excludes Restricted Cash & Temporary Investments used for purposes of complying with RIC requirements from cash equivalents.

**Income Taxes** The Fund intends to comply with the requirements of the Internal Revenue Code necessary to qualify as a regulated investment company and, as such, will not be subject to federal income taxes on otherwise taxable income (including net realized capital gains) which is distributed to stockholders. Therefore, no provision for federal income taxes is recorded in the financial statements. The Fund borrows money from time to time to maintain its tax status under the Internal Revenue Code as a RIC. See Note 2 for further discussion of the Fund's RIC borrowings.

In May 2006, the State of Texas enacted a bill that replaced the existing franchise tax with a margin tax. Effective January 1, 2007, the margin tax applies to legal entities conducting business in Texas, including previously non-taxable entities such as limited partnerships and limited liability partnerships. The margin tax is based on our Texas sourced taxable margin. The tax is calculated by applying a tax rate to a base that considers both revenue and expenses and therefore has the characteristics of an income tax. As a result, the Fund recorded \$0.01 million and \$0.1 million in state income tax for the year ended December 31, 2008 and 2007, respectively, that is solely attributable to the Texas margin tax.

**Fair Value Measurement** In September 2006, the Financial Accounting Standard Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, outlines a fair value hierarchy based on inputs used to measure fair value and enhances disclosure requirements for fair value measurements. SFAS 157 does not change existing guidance as to whether an instrument is carried at fair value. The Fund adopted SFAS 157 for the quarter ending March 31, 2008. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The Fund has categorized all investments recorded at fair value in accordance with SFAS 157 based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by SFAS 157 and directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities, are as follows:

Level 1 Inputs are unadjusted, quoted prices in active markets for identical assets at the measurement date. The types of assets carried at Level 1 fair value generally are equities listed in active markets.

Level 2 Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset in connection with market data at the measurement date and for the extent of the instrument's anticipated life. Fair valued assets that are generally included in this category are warrants held in a public company.

Level 3 Inputs reflect management's best estimate of what market participants would use in pricing the asset at the measurement date. It includes prices or valuations that require inputs that are both significant to

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the fair value measurement and unobservable. Generally, assets carried at fair value and included in this category are debt, warrants and/or other equity investments held in a private company. For loan and debt securities, the Fund has performed a yield analysis assuming a hypothetical current sale of the security. The yield analysis considers changes in interest rates and changes in leverage levels of the portfolio company as compared to the market interest rates and leverage levels. Assuming the credit quality of the portfolio company remains stable, the Fund will use the value determined by the yield analysis as the fair value for that security.

The Fund will record unrealized depreciation on investments when it determines that the fair value of a security is less than its cost basis, and will record unrealized appreciation when it determines that the fair value is greater than its cost basis.

Investments measured at fair value on a recurring basis are categorized in the tables below based on the lowest level of significant input to the valuations:

(in thousands)	Fair Value Measurements As of December 31, 2008			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	Total			
Assets				
Investments:				
Control investments				37,190
Affiliate investments				20,974
Non-Affiliate investments		737		10,135
Total assets reported at fair value	\$ 69,036	\$	\$ 737	\$ 68,299

The following table provides a reconciliation of fair value changes during 2008 for all investments for which we determine fair value using unobservable (Level 3) factors.

(in thousands)	Fair value measurements using unobservable inputs (Level 3)			
	Control Investments	Affiliate Investments	Non-affiliate Investments	Total
Fair value as of January 1, 2008	\$ 25,646	\$ 32,111	\$ 14,345	\$ 72,102
Total realized gains	625	351	(52)	924
Change in unrealized appreciation	(354)	(14,769)	(4,750)	(19,873)
Purchases, issuances and settlements, net	4,581	3,281	8,021	15,883
Change in control	6,692		(6,692)	
Transfers in (out) of Level 3			(737)	(737)
Fair value as of December 31, 2008	\$ 37,190	\$ 20,974	\$ 10,135	\$ 68,299

**Reclassification** Certain amounts for the years ended December 31, 2007 and 2006 have been reclassified in the comparative financial statements to be comparable to the presentation in the year ended December 31, 2008. These reclassifications had no effect on net income or net assets.

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**DECEMBER 31, 2008, 2007 AND 2006**

**(4) RELATED PARTY TRANSACTIONS AND AGREEMENTS**

The Fund entered into an investment advisory agreement dated June 30, 2005 (the "Advisory Agreement") with Moore Clayton Capital Advisors, Inc. (the "Adviser"). This agreement was renewed in June 2008. Pursuant to the Advisory Agreement, the Adviser performs certain investment advisory services that are necessary for the operation of the Fund. The Adviser receives a base advisory fee at an annual rate of 2% of the net assets of the Fund, paid quarterly in arrears, as well as incentive fees in the following amounts: (i) 20% of the excess, if any, of the Fund's net investment income for a quarter that exceeds a quarterly hurdle rate equal to 2% (8% annualized) of the Fund's net assets, and (ii) 20% of the Fund's net realized capital gain less unrealized capital depreciation paid on an annual basis. The advisory fees that the Fund pays represent the Adviser's primary source of revenue. The Adviser is a group company of Moore, Clayton & Co., Inc., an international private equity investment and advisory firm. The Adviser is controlled by Anthony Moore and Kenneth Denos, both directors of the Fund, who hold non-dividend super voting preferred shares in the Adviser.

The Advisory Agreement presently continues year-to-year, provided such continuance is approved at least annually by (i) a vote of a majority of the outstanding shares of the Fund, or (ii) a majority of the Independent Directors of the Fund. The Advisory Agreement may be terminated at any time, without the payment of any penalty, by the Board of Directors or the holders of a majority of the Fund's shares on 60 days' written notice to the Adviser, and would automatically terminate in the event of its assignment (as defined in the 1940 Act).

The Fund also entered into an administration agreement dated June 30, 2005 ("Administration Agreement") with Equus Capital Administration Company, Inc. (the "Administrator"). This agreement was renewed in June 2008. The Fund agreed to reimburse the Administrator certain one-time costs and expenses ("Special Administrative Fee") associated with the change in administrators. The Special Administrative Fee, in the amount of \$0.5 million, was accrued to expense at June 30, 2005, and paid to the Administrator in the third quarter of 2005. Pursuant to the Administration Agreement, the Administrator provides (or arranges for suitable third parties to provide) all administrative services necessary for the operation of the Fund. The Fund reimburses the Administrator for the costs and expenses incurred by the Administrator in performing its obligations and providing personnel and facilities under the Administrative Agreement, provided that such reimbursements do not exceed \$0.5 million per year, excluding the one-time Special Administrative Fee.

The Administration Agreement presently continues year-to-year, provided such continuance is approved at least annually by the Fund's Board of Directors, including a majority of the Independent Directors. The Administration Agreement may be terminated at any time, without the payment of any penalty, by the Board of Directors, or by the Administrator, upon 60 days' written notice to the other party, and would automatically terminate in the event of its assignment (as defined in the 1940 Act).

As compensation for services to the Fund, each Independent Director receives an annual fee of \$20,000 paid quarterly in arrears, a fee of \$2,000 for each meeting of the Board of Directors attended in person, a fee of \$1,000 for participation in each telephonic meeting of the Board and a fee of \$1,000 for each committee meeting attended, and reimbursement of all out-of-pocket expenses relating to attendance at such meetings. Effective July 1, 2006, a new quarterly fee of \$2,500 was approved and paid for the Chairman of the Independent Directors and the Chairman of the Audit Committee. An additional one-time fee of \$5,000 was paid to the Chairman of the Independent Directors and the Chairman of the Audit Committee in September 2007, as approved by the Compensation Committee. Effective December 18, 2007, an annual fee of \$15,000 for the Chairman of the Board of Directors was approved.

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**DECEMBER 31, 2008, 2007 AND 2006**

**(5) FEDERAL INCOME TAX MATTERS**

The Fund is required to make distributions of any net taxable investment income on an annual basis, and may elect to distribute or retain net taxable realized capital gains. The Internal Revenue Service approved the Fund's request, effective October 31, 1998, to change its year-end for determining capital gains for purposes of Section 4982 of the Internal Revenue Code from December 31 to October 31.

The Fund was not required to make distributions of ordinary income for 2008, 2007, or 2006 under income tax regulations.

For the year ended December 31, 2008, the Fund had a net investment loss for book purposes of \$1.0 million and \$1.0 for tax purposes. During 2008, the Fund had a net capital gain for book purposes of \$0.9 million and a net capital gain for tax purposes of \$1.0. As of December 31, 2008, the Fund has no capital loss carry-forward. The aggregate cost of investments for federal income tax purposes as of December 31, 2008 was \$69.2 million. Such investments had unrealized appreciation of \$15.6 and unrealized depreciation of \$18.7 for book purposes, or net unrealized depreciation of \$3.1 million. The Fund had unrealized appreciation of \$19.3 million and unrealized depreciation of \$19.5 million for tax purposes, or net unrealized appreciation of \$0.2 million as of December 31, 2008.

For the year ended December 31, 2007, the Fund had a net investment loss for book purposes of \$0.5 million and \$0.5 million for tax purposes. During 2007, the Fund had a net capital gain for book purposes of \$5.3 million and a net capital gain for tax purposes of \$5.1 million. As of December 31, 2007, the Fund has no capital loss carry-forward as it was fully utilized to offset capital gains in 2006. The aggregate cost of investments for federal income tax purposes as of December 31, 2007 was \$52.7 million. Such investments had unrealized appreciation of \$23.4 million and unrealized depreciation of \$6.5 million for book purposes, or net unrealized appreciation of \$16.8 million. The Fund had unrealized appreciation of \$26.4 million and unrealized depreciation of \$7.0 million for tax purposes, or net unrealized appreciation of \$19.4 million as of December 31, 2007.

For the year ended December 31, 2006, the Fund had a net investment loss for book purposes of approximately \$0.1 and \$0.1 million for tax purposes. During 2006, the Fund had a net capital gain for book purposes of approximately \$19.0 million and a net capital gain for tax purposes of \$21.4 million. As of December 31, 2006, the Fund has no capital loss carry-forward as it was fully utilized to offset capital gains in 2006. The aggregate cost of investments for federal income tax purposes as of December 31, 2006 was \$30.9 million. Such investments had unrealized appreciation of approximately \$12.7 million and unrealized depreciation of \$3.4 million for book purposes, or net unrealized appreciation of approximately \$9.3 million. The Fund had unrealized appreciation of approximately \$16.2 million and unrealized depreciation of approximately \$4.2 million for tax purposes, or net unrealized appreciation of approximately \$12.0 million as of December 31, 2006.

The Fund adopted FASB Interpretation No. 48 entitled "Accounting for Uncertainty in Income Taxes" an interpretation of FASB Statement No. 109, referred to as "FIN 48," as of January 1, 2007. FIN 48 clarifies the accounting for uncertain tax positions that may have been taken by an entity. Specifically, FIN 48 prescribes a more-likely-than-not recognition threshold to measure a tax position taken or expected to be taken in a tax return through a two-step process: (1) determining whether it is more likely than not that a tax position will be sustained upon examination by taxing authorities, after all appeals, based upon the technical merits of the position; and (2) measuring to determine the amount of benefit/expense to recognize in the financial statements, assuming taxing authorities have all relevant information concerning the issue. The tax position is measured at the largest amount of benefit/expense that is greater than 50 percent likely of being realized upon ultimate settlement. This

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pronouncement also specifies how to present a liability for unrecognized tax benefits in a classified balance sheet, but does not change the classification requirements for deferred taxes. Under FIN 48, if a tax position previously failed the more-likely-than-not recognition threshold, it should be recognized in the first subsequent financial reporting period in which the threshold is met. Similarly, a position that no longer meets this recognition threshold should no longer be recognized in the first financial reporting period that the threshold is no longer met.

The Fund is a flow through, non-tax paying entity; further, the Fund's net operating loss carry-forwards have been exhausted. Based upon an examination of the Fund's tax position, the Fund determined that the aggregate exposure under FIN 48 did not have a material impact on its financial statements as of January 1, 2008 or as of December 31, 2008. Therefore, the Fund has not recorded an adjustment to its financial statements related to the adoption of FIN 48. The Fund will continue to evaluate its tax positions in accordance with FIN 48, and recognize any future impact under FIN 48 as a charge to income in the applicable period in accordance with the standard.

The Fund's accounting policy related to income tax penalties and interest assessments is to accrue for these costs and record a charge to expenses during the period that the Fund takes an uncertain tax position through resolution with the taxing authorities or expiration of the applicable statute of limitations.

All of the Fund's state income tax returns for 2005 through 2008 remain open to examination.

**(6) CONTRACTUAL OBLIGATIONS**

The Fund has entered into four contracts under which it expects to have material future commitments, including the Advisory Agreement between the Fund and the Adviser, pursuant to which the Adviser has agreed to serve as the Fund's investment advisor; the Administration Agreement between the Fund and the Administrator, pursuant to which the Administrator has agreed to furnish the Fund with the facilities and administrative services necessary to conduct the Fund's day-to-day operations and to provide managerial assistance on its behalf to portfolio companies to which the Fund is required to provide such assistance. Both the Advisory Agreement and the Administration Agreement may be terminated by either party without a penalty upon not more than 60 days written notice to the other. For a discussion of the material terms of the Advisory Agreement and the Administration Agreement, see Note 4.

The remaining two commitments as of December 31, 2008 relate to the Fund's portfolio securities and are summarized as follows (in thousands):

<b>Portfolio Company</b>	<b>Original Commitment</b>	<b>Remaining Commitment</b>
HealthSPAC, LLC(1)	\$ 5,000	\$ 3,227
RP&C International Investments LLC	11,100	1,000
		\$ 4,227

(1) Funding of the remaining commitment has been postponed until 2010 at the earliest.

**(7) DIVIDENDS**

The Fund declared four dividends in 2008 amounting to \$5.3 million (\$0.63 per share). The Fund paid \$2.1 million in cash and issued 587,899 additional shares of stock. The 2008 dividends were 100% qualified and classified as 39% capital gain and 61% return of capital. See also Note 10 Subsequent events.





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The Fund declared four dividends in 2007 amounting to \$4.1 million (\$0.50 per share). The Fund paid \$2.3 million in cash and issued 236,930 additional shares of stock in 2007. The 2007 dividends were 100% qualifying and classified as capital gain distributions.

The Fund declared two dividends during 2006 amounting in total to \$19.5 million (\$2.625 per share). The 2006 dividends were primarily the result of the net taxable realized gain from the sale of Champion Window Holdings, Inc. The 2006 dividends were paid in additional shares of common stock or in cash by specific election made by each shareholder. The Fund paid \$13.5 million in cash for both dividends (\$13.0 million paid on March 23, 2006 and \$0.5 million paid on December 7, 2006) and issued 787,099 additional shares of stock (729,773 shares at \$7.489 per share and 57,326 shares at \$8.081 per share). On October 23, 2006, the Fund announced a quarterly managed dividend policy where the Fund hopes to issue dividends at a minimum annual rate of \$0.50 per share.

**(8) PORTFOLIO SECURITIES****2008 Portfolio Activity**

During the year ended December 31, 2008, the Fund invested \$8.1 million in new portfolio companies and made follow-on investments of \$11.6 million in several follow-on investments, including \$0.6 million in the form of interest and dividends paid-in-kind or original issue discount/premium amortization.

The following table includes significant new and follow-on investments during the year ended December 31, 2008 (in thousands):

Portfolio Company	New		Follow-On		Total
	Cash	Noncash	Cash	Noncash	
Infinia Corporation	\$	\$	\$ 5,000	\$	\$ 5,000
Riptide Entertainment, LLC			4,725		4,725
1848 Capital Partners LLC	3,000	135			3,135
London Bridge Entertainment LLC	2,500				2,500
Trulite, Inc.	1,500				1,500
Nickent Golf, Inc.			1,180	184	1,364
Metic Solutions, PLC	1,000				1,000
ConGlobal Industries Holding, Inc.				305	305
HealthSpac, LLC			208		208
Various others				7	7
	\$ 8,000	\$ 135	\$ 11,113	\$ 496	\$ 19,744

During the year ended December 31, 2008, the Fund realized capital gains of \$0.9 million, including the following significant transactions (in thousands):

Portfolio Company	Industry	Type	Realized Gain/(Loss)
ConGlobal Industries Holding, Inc.	Shipping products and services	Control, non-majority	\$ 625
RP&C International Investments LLC	Healthcare	Affiliate	351
Various others			(52)



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During 2008, the Fund's net unrealized appreciation on investments decreased by \$19.6 million to a net unrealized depreciation position of \$2.8 million as of December 31, 2008. This decrease in appreciation resulted primarily from the decrease in the estimated fair values of Nickent Golf, Inc., Infinia Corporation and Creekstone Florida Holdings, LLC, which the Fund revalued based on current market conditions and operations in 2008. The Fund had additional increases in unrealized appreciation due to increases in fair value of two portfolio companies aggregating \$4.6 million. This change was primarily comprised of ConGlobal Industries and Sovereign Business Forms.

**2007 Portfolio Activity**

During the year ended December 31, 2007, the Fund invested \$21.2 million in four new companies and made follow-on investments of \$7.0 million in follow-on investments, including \$0.7 million in the form of interest and dividends paid in kind or original issue discount/premium amortization.

The following table includes significant new and follow-on investments during the year ended December 31, 2007 (in thousands):

Portfolio Company	New		Follow-On		Total
	Cash	Noncash	Cash	Noncash	
Nickent Golf, Inc.	\$ 10,000	\$ 66	\$	\$	\$ 10,066
Equus Media Development Company, LLC	5,000				5,000
Riptide Entertainment, LLC			3,835		3,835
Big Apple Entertainment Partners LLC	3,000				3,000
Infinia Corporation	3,000				3,000
RP&C International Investments LLC			2,009		2,009
Various others	100		525	670	1,295
	\$ 21,100	\$ 66	\$ 6,369	\$ 670	\$ 28,205

During the year ended December 31, 2007, the Fund realized capital gains of \$5.3 million, including the following significant transactions (in thousands):

Portfolio Company	Industry	Type	Realized Gain/(Loss)
The Drilltec Corporation	Industrial products and services	Non-affiliate	\$ 3,830
Champion Window Holdings, Inc.	Residential building products	Control	1,403
Cedar Lodge Holdings, Inc.	Real estate	Control	609
TurfGrass America Inc.	Residential building products	Control	(960)
Various others			381
			\$ 5,264

During 2007, the Fund's net unrealized appreciation on investments increased by \$7.5 million to a net unrealized appreciation position of \$16.8 million as of December 31, 2007. This increase in appreciation resulted primarily from the increase in the estimated fair value of Infinia Corporation, which the Fund revalued based on a subsequent round of financing completed in early 2008. The increase in appreciation also resulted from the



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transfer of \$1.0 million in net unrealized depreciation to net realized depreciation in connection with the Fund's write-off of Turf Grass Holdings, Inc. These increases were partially offset by the Fund's transfer of \$2.0 million in net unrealized appreciation to net realized appreciation related to the sale of Drilltec Corporation. The Fund had additional decreases in unrealized appreciation due to decreases in fair value of four portfolio companies aggregating \$9.0 million. This change was primarily comprised of ConGlobal Industries, PalletOne, Inc, Sovereign Business Forms and Spectrum Management LLC.

**2006 Portfolio Activity**

During the year December 31, 2006, the Fund invested \$1.3 million in new portfolio companies and made follow-on investments of \$9.8 million in several follow-on investments, including \$1.3 million in the form of interest and dividends paid-in-kind or original issue discount/premium amortization.

The following table includes significant new and follow-on investments during the year ended December 31, 2006 (in thousands):

Portfolio Company	New		Follow-On		Total
	Cash	Noncash	Cash	Noncash	
Cedar Lodge Holdings, Inc.	\$	\$	\$ 8,011	\$ (109)	\$ 7,902
RP&C International Investments LLC	1,296				1,296
Conglobal Industries Holding, Inc.				893	893
Riptide Entertainment, LLC			500		500
Various others	40		13	468	521
	\$ 1,336	\$	\$ 8,524	\$ 1,252	\$ 11,112

During the year ended December 31, 2006, the Fund realized capital gains of \$19.0 million, including the following significant transactions (in thousands):

Portfolio Company	Industry	Type	Realized Gain/(Loss)
Champion Window Holdings, Inc.	Residential building products	Control	\$ 26,969
Jones Industrial Holdings, Inc.	Industrial products and services	Control	1,137
Doane PetCare Enterprises, Inc.	Consumer goods and services	Affiliate	1,034
Equicom, Inc.	Media	Control	(10,334)
Various others			206
			\$ 19,012

During 2006, the Fund recorded an increase in net unrealized depreciation on investments of \$4.8 million from a net unrealized appreciation position of \$14.0 million to a net unrealized appreciation position of \$9.3 million as of December 31, 2006. This decrease in appreciation resulted primarily from the transfer of \$27.0 million and \$1.1 million in net unrealized appreciation to net realized appreciation in connection with the Fund's investment in Champion and Jones Industrial Holdings, Inc., respectively. This increase in depreciation also resulted from the transfer of \$0.4 million and \$1.0 million in net unrealized appreciation to net realized appreciation for escrow accounts related to the disposition of Alenco Window Holdings, LLC and Doane PetCare



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**EQUUS TOTAL RETURN, INC.**

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Enterprises, Inc., respectively. These increases were partially offset by the Fund's transfer of \$10.3 million and \$0.5 million in net unrealized depreciation to net realized depreciation related to the sale of Equicom, Inc. and CMC Investment, LLC, respectively. The Fund had additional decreases in unrealized appreciation due to increases in the estimated fair value of eight of its portfolio companies aggregating \$14.1 million. This change was primarily comprised of PalletOne, Inc., The Drilltec Corporation and ConGlobal Industries, Inc. resulting from improved operating performances by these companies. We had additional increases in unrealized depreciation, which resulted from decreases in the estimated fair value of two portfolio companies, amounting to \$0.1 million.

**(9) RECENT ACCOUNTING PRONOUNCEMENTS**

**Fair Value Measurements** On February 12, 2008, *FASB Staff Position No. FAS 157-2 Effective Date of FASB No. 157*, or FSP 157-2 was issued, which deferred the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008, with early adoption permitted in certain cases. We deferred the adoption of SFAS 157 for our nonfinancial assets and liabilities. We are assessing the potential impact that adoption of SFAS 157 for our nonfinancial assets and liabilities may have on our financial statements.

On October 10, 2008, *FASB Staff Position No. 157-3 Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, or FSP 157-3, was issued. FSP 157-3 provides an illustrative example of how to determine the fair value of a financial asset in an inactive market. The FSP does not change the fair value measurement principles set forth in SFAS 157. Since adopting SFAS 157 in January 2008, our practices for determining the fair value of our investment portfolio have been, and continue to be, consistent with the guidance provided in the example in FSP 157-3. Therefore, our adoption of FSP 157-3 did not affect our practices for determining the fair value of our investment portfolio and does not have a material effect on our financial position or results of operations.

**Fair Value Option for Financial Assets and Financial Liabilities** In February 2007, the Financial Accounting Standards Board issued *Statement of Financial Accounting Standards No. 159 The Fair Value Option for Financial Assets and Financial Liabilities*, or SFAS 159. Among other requirements, SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 was effective for the first fiscal year that begins after November 15, 2008. Based upon our review, we have elected not to adopt SFAS 159 for financial liabilities that were in our portfolio as of December 31, 2008. However, we may elect to apply SFAS 159 to future financial liabilities. The impact on our financial statements from the potential application of SFAS 159 to a future liability depends upon the attributes of the specific financial liability.

**(10) SUBSEQUENT EVENTS**

On January 2, 2009, the Fund sold U.S. Treasury Bills for \$45.0 million and repaid its year-end margin loan.

On February 27, 2009, the Fund announced the declaration of a first quarter dividend of \$0.1075 per share in accordance with the Fund's revised managed distribution policy, pursuant to which it intends to pay 10% of the Fund's market value based on the 2008 year-end closing price of \$4.30. This dividend is payable on March 30, 2009 to shareholders of record as of March 9, 2009. The dividend will be payable in shares of common stock. The classification of this dividend as between ordinary income, capital gain and return of capital will not be known until December 31, 2009, since any purchase or sale of a portfolio security during the remainder of the year will affect the classification.



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On March 24, 2009, the Fund announced that it suspended its managed distribution policy and payment of quarterly distributions for an indefinite period, following the distribution of the first quarter dividend to be paid on March 30, 2009.

**(11) SELECTED QUARTERLY DATA (in thousands, except per share amounts)**

	Year Ended December 31, 2008				TOTAL
	Quarter Ended March 31, 2008	Quarter Ended June 30, 2008	Quarter Ended September 30, 2008	Quarter Ended December 31, 2008	
(in thousands, except per share amounts)					
Total investment income	\$ 1,334	\$ 747	\$ 292	\$ 808	\$ 3,181
Net investment gain (loss)	\$ 409	\$ (504)	\$ (625)	\$ 7	(713)
Increase (decrease) in net assets resulting from operations	1,134	61	(5,060)	(15,797)	(19,662)
Net increase (decrease) in net assets resulting from operations per share, basic and diluted	\$ 0.13	\$ 0.01	\$ (0.60)	\$ (1.87)	\$ (2.33)

	Year Ended December 31, 2007				TOTAL
	Quarter Ended March 31, 2007	Quarter Ended June 30, 2007	Quarter Ended September 30, 2007	Quarter Ended December 31, 2007	
(in thousands, except per share amounts)					
Total investment income	\$ 1,211	\$ 1,271	\$ 1,151	\$ 1,224	\$ 4,857
Net investment gain (loss)	5	(711)	(289)	472	(523)
Increase (decrease) in net assets resulting from operations	(572)	661	(3,799)	15,977	12,267
Net increase (decrease) in net assets resulting from operations per share, basic and diluted	\$ (0.07)	\$ 0.08	\$ (0.46)	\$ 1.94	\$ 1.49

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**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

Attached as exhibits to this Form 10-K are certifications of the Fund's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the Exchange Act). This section includes information concerning the controls and controls evaluation referred to in those certifications and should be read in conjunction with the certifications for a more complete understanding of the topics presented.

**Evaluation of Disclosure Controls and Procedures**

The Fund conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (Disclosure Controls) as of the end of the period covered by this Form 10-K. The controls evaluation was conducted under the supervision and with the participation of management, including the Fund's CEO and CFO. Disclosure Controls are controls and procedures designed to reasonably assure that information required to be disclosed in the Fund's reports filed under the Exchange Act, such as this Form 10-K, is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms. Disclosure Controls are also designed to reasonably assure that such information is accumulated and communicated to the Fund's management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. The Fund's quarterly evaluation of Disclosure Controls includes an evaluation of some components of its internal control over financial reporting, and internal control over financial reporting is also separately evaluated on an annual basis for purposes of providing the management report which is set forth below.

The evaluation of the Fund's Disclosure Controls included a review of the controls' objectives and design, the Fund's implementation of the controls and the effect of the controls on the information generated for use in this Form 10-K. In the course of the controls evaluation, the Fund reviewed identified data errors, control problems or acts of fraud and sought to confirm that appropriate corrective actions, including process improvements, were being undertaken. This type of evaluation is performed on a quarterly basis so that the conclusions of management, including the CEO and CFO, concerning the effectiveness of the Disclosure Controls can be reported in the Fund's periodic reports on Form 10-Q and Form 10-K. Many of the components of the Fund's Disclosure Controls are also evaluated on an ongoing basis by a third-party consultant and the Accounting Department. The overall goals of these various evaluation activities are to monitor the Fund's Disclosure Controls, and to modify them as necessary. The Fund's intent is to maintain the Disclosure Controls as dynamic systems that change as conditions warrant.

Based upon the controls evaluation, the Fund's CEO and CFO have concluded that, subject to the limitations noted in this Part II, Item 9A, as of the end of the period covered by this Form 10-K, the Fund's Disclosure Controls were effective to provide reasonable assurance that information required to be disclosed in its Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC, and that material information relating to the Fund's consolidated subsidiaries is made known to management, including the CEO and CFO, particularly during the period when its periodic reports are being prepared.

**Management Report on Internal Control Over Financial Reporting**

The Fund's management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of its financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting

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principles. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Fund are being made only in accordance with authorizations of management and directors of the Fund; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Fund's assets that could have a material effect on the financial statements.

Management assessed its internal control over financial reporting as of December 31, 2008, the end of its fiscal year. Management based its assessment on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management's assessment included evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies, and our overall control environment. This assessment is supported by testing and monitoring performed both by a third-party consultant and our Accounting Department.

Based on its assessment, management has concluded that its internal control over financial reporting was effective as of the end of the fiscal year to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles. The results of management's assessment has been reviewed with the Audit Committee of the Fund's Board of Directors.

### **Item 9B. Other Information**

None.

## **PART III**

### **Item 10. Directors and Executive Officers of the Registrant**

Information about the Directors and Executive Officers of the Fund, the Fund's Audit Committee and the Nominating and Corporate Governance Committee, the Fund's code of ethics applicable to the principal executive officer and principal financial officer, and Section 16(a) Beneficial Ownership Reporting Compliance is incorporated by reference to the Fund's Definitive Proxy Statement for the 2009 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, on or prior to April 1, 2009 (the 2009 Proxy Statement).

The Fund has adopted a code of business conduct and ethics applicable to the Fund's directors, officers (including the Fund's principal executive officer, principal financial officer and controller) and employees, known as the Code of Business Conduct and Ethics. A copy of the Code of Business Conduct and Ethics is available to any person, without charge, upon request addressed to Equus Total Return, Inc., Attention: Corporate Secretary, 2727 Allen Parkway, 13<sup>th</sup> Floor, Houston, TX 77019. In the event that the Fund amends or waives any of the provisions of the Code of Business Conduct and Ethics applicable to the Fund's principal executive officer, principal financial officer, or controller, the Fund intends to disclose the same on its website at [www.equuscap.com](http://www.equuscap.com).

### **Item 11. Executive Compensation**

Information regarding Executive Compensation is incorporated by reference to the Fund's 2009 Proxy Statement.

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**Item 12. Security Ownership of Certain Beneficial Owners and Management**

Information regarding Security Ownership of Certain Beneficial Owners and Management and Securities Authorized for Issuance under Equity Compensation Plans is incorporated by reference to the Fund's 2009 Proxy Statement.

**Item 13. Certain Relationships and Related Transactions**

Information regarding Certain Relationships and Related Transactions is incorporated by reference to the Fund's 2009 Proxy Statement.

**Item 14. Principal Accountant Fees and Services**

Information regarding Principal Accountant Fees and Services is incorporated by reference to the Fund's 2009 Proxy Statement.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K**

**(a)(1) Financial Statements**

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All other information required in the financial statement schedules has been incorporated in the financial statements or notes thereto or has been omitted since the information is not applicable or not present in amounts sufficient to require submission of the schedule.

**(a)(3) Exhibits**

3. Articles of Incorporation and by-laws.

- (a) Restated Certificate of Incorporation of the Fund, as amended. [Incorporated by reference to Exhibit 3(a) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2007.]
- (b) Certificate of Merger dated June 30, 1993, between the Fund and Equus Investments Incorporated. [Incorporated by reference to Exhibit 3(b) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2007.]
- (c) Amended and Restated Bylaws of the Fund. [Incorporated by reference to Exhibit 3(c) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2007.]



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10. Material Contracts.

- (a) Investment Advisory Agreement dated June 30, 2005, between the Fund and Moore, Clayton Capital Advisors, Inc. [Incorporated by reference to Exhibit 10(a) to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005.]
- (b) Administration Agreement dated June 30, 2005, between the Fund and Equus Capital Administration Company. [Incorporated by reference to Exhibit 10(b) to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005.]
- (c) Safekeeping Agreement between the Fund and Amegy Bank dated August 16, 2008. [Filed herewith.]
- (d) Form of Indemnification Agreement between the Fund and its directors and certain officers. [Incorporated by reference to Exhibit 10(g) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2004.]
- (e) Form of Release Agreement between the Fund and certain of its officers and former officers. [Incorporated by reference to Exhibit 10(h) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2004.]
- (f) Joint Code of Ethics of the Fund and Moore Clayton Capital Advisors, Inc. (Rule 17j-1) [Incorporated by reference to Exhibit 10(h) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2007.]
- (g) Revolving Credit Note between the Fund and Amegy Bank National Association dated August 13, 2008. [Incorporated by reference to Exhibit 10 (g) to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008.]
- (h) Pledge and Security Agreement between the Fund and Amegy Bank National Association dated August 13, 2008. [Incorporated by reference to Exhibit 10 (h) to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008.]

14. Code of Ethics (meeting the requirements of Section 406 of the Sarbanes-Oxley Act of 2002) [To be filed as an exhibit to the 2009 Proxy Statement.]

31. Rule 13a-14(a)/15d-14(a) Certifications

- (1) Certification by Chairman and Chief Executive Officer
- (2) Certification by Chief Financial Officer

32. Section 1350 Certification

- (1) Certification by Chairman and Chief Executive Officer

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(2) Certification by Chief Financial Officer

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed by the undersigned, thereunto duly authorized.

EQUUS TOTAL RETURN, INC.

Date: March 31, 2009

/s/ L SHERYL D. HUDSON  
**L Sheryl D. Hudson**  
**Chief Financial Officer**

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ RICHARD F. BERGNER <b>Richard F. Bergner</b>	Director	March 31, 2009
/s/ CHARLES M. BOYD, MD <b>Charles M. Boyd</b>	Director	March 31, 2009
/s/ ALAN D. FEINSILVER <b>Alan D. Feinsilver</b>	Director	March 31, 2009
/s/ GREGORY J. FLANAGAN <b>Gregory J. Flanagan</b>	Chairman of the Board	March 31, 2009
/s/ HENRY W. HANKINSON <b>Henry W. Hankinson</b>	Director	March 31, 2009
/s/ ROBERT L. KNAUSS <b>Robert L. Knauss</b>	Director	March 31, 2009
/s/ FRANCIS D. TUGGLE <b>Francis D. Tuggle</b>	Director	March 31, 2009
/s/ SAM P. DOUGLASS <b>Sam P. Douglass</b>	Director	March 31, 2009
/s/ ANTHONY R. MOORE <b>Anthony R. Moore</b>	Director	March 31, 2009
/s/ KENNETH I. DENOS <b>Kenneth I. Denos</b>	Chief Executive Officer (Principal Executive Officer)	March 31, 2009
/s/ L. SHERYL D. HUDSON <b>L. Sheryl D. Hudson</b>	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 31, 2009