

EQUUS TOTAL RETURN, INC.  
Form 10-K  
March 30, 2015

**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**

**For the year ended December 31, 2014**

**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 814-00098**

**EQUUS TOTAL RETURN, INC.**

**(Exact name of registrant as specified in its charter)**

**Delaware 76-0345915**

**(State or other jurisdiction of**

**incorporation or organization)**

**(I.R.S. Employer Identification No.) 700 Louisiana St. 48th Floor, Houston, Texas 77002 (Address of principal executive offices) (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**

**on which registered**

**Common Stock 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: \$31,430,642 computed on the basis of \$2.48 per share, closing price of the common stock on the New York Stock Exchange on June 30, 2014. For purposes of calculating this amount only, all directors and executive officers of the registrant have been treated as affiliates. There were 12,673,646 shares of the registrant's common stock, \$.001 par value, outstanding as of March 30, 2015. The net asset value of a share of the Registrant as of December 31, 2014 was \$2.86.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).

Portions of the Proxy Statement (to be filed) for the 2015 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. (“we,” “us,” “our,” “*Equus*” the “*Company*” or the “*Fund*”), 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. On August 11, 2006, our shareholders approved the change of the Fund’s investment strategy to a total return investment objective. This 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.

We attempt to maximize the return to stockholders in the form of current investment income and long-term capital gains by investing in the debt and equity securities of companies with a total enterprise value of between \$5.0 million and \$75.0 million, although we may engage in transactions with smaller or larger investee companies from time to time. We seek to invest primarily in companies pursuing growth either through acquisition or organically, leveraged buyouts, management buyouts and recapitalizations of existing businesses or special situations. Our income-producing investments consist principally of debt securities including bonds, subordinated debt, debt convertible into common or preferred stock, or debt combined with warrants and common and preferred stock. Debt and preferred equity financing may also be used to create long-term capital appreciation through the exercise and sale of warrants received in connection with the financing. We seek to achieve capital appreciation by making investments in equity and equity-oriented securities issued by privately-owned companies or smaller public companies in transactions negotiated directly with such companies. Given market conditions over the past several years and the performance of our portfolio, our management and board of directors believe it prudent to continue to review alternatives to refine and further clarify the current strategies.

Equus is a closed-end management investment company that has elected to be treated as a business development company (“BDC”) under the Investment Company Act of 1940 (“1940 Act”). In order to remain a BDC, we must meet certain specified requirements under the 1940 Act, including investing at least 70% of our assets in eligible portfolio companies and limiting the amount of leverage we incur. Equus is also a regulated investment company (“RIC”) under Subchapter M of the U.S. Internal Revenue Code of 1986. As such, we are not required to pay corporate-level income tax on the Fund’s investment income. We intend to maintain our RIC status, which requires that we qualify annually as a RIC by meeting certain specified requirements. For a discussion of these requirements necessary to maintain our status as a BDC and as a RIC, please see “Business Development Company Requirements” and “Regulated Investment Company Tax Status,” respectively.

Our principal office is located at 700 Louisiana St., 48th Floor, Houston, Texas, 77002, and the telephone number is 1-888-358-7575. Our corporate website is located at [www.equuscap.com](http://www.equuscap.com). We make available free of charge on our

website our 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”). Our shares are traded on The New York Stock Exchange under the ticker symbol “EQS”.

## Significant Developments

*Plan of Reorganization and Share Exchange with MVC Capital.* On May 14, 2014, we announced that the Fund intended to effect a reorganization pursuant to Section 2(a)(33) of the 1940 Act. As a first step to consummating the reorganization, we sold to MVC Capital, Inc. (“MVC”) 2,112,000 newly-issued shares of the Fund’s common stock in exchange for 395,839 shares of MVC (such transaction is hereinafter referred to as the “Share Exchange”). MVC is a business development company traded on the New York Stock Exchange that provides long-term debt and equity investment capital to fund growth, acquisitions and recapitalizations of companies in a variety of industries. The Share Exchange was calculated based on the Fund’s and MVC’s respective net asset value per share. At the time of the Share Exchange, the number of MVC shares received by Equus represented approximately 1.73% of MVC’s total outstanding shares of common stock.

Pursuant to the terms of a Share Exchange Agreement, dated May 12, 2014, entered into by Equus and MVC which memorialized the Share Exchange, we intend to finalize the reorganization by pursuing a merger or consolidation with MVC, a subsidiary of MVC, or one or more of MVC’s portfolio companies (the “Consolidation”). Absent Equus merging or consolidating with/into MVC or a subsidiary thereof, our current intention is for Equus to (i) consummate the Consolidation with a portfolio company of MVC, (ii) terminate its election to be classified as a BDC under the 1940 Act, and (iii) be restructured as a publicly-traded operating company focused on the energy and/or financial services sector. Our original intention was to consummate the Consolidation within one year from the date of our announcement, although actual completion may require additional time.

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*Disposals of Portfolio Investments.* During 2014 and shortly thereafter, we disposed of the following portfolio investments:

- On April 3, 2014, we sold our remaining 73,666 shares of Orco Property Group S.A. (“OPG”), wherein we received \$61,867 in net cash proceeds;
- On November 20, 2014, we received a payment in partial redemption of our notes issued by OPG (“OPG Notes”) in the amount of €209,706 [\$261,077];
- On January 6, 2015, we sold our interest in Spectrum Management, L.L.C. (“Spectrum”) in exchange for \$3.0 million in cash and a 1-year secured subordinated 14% promissory note in the principal amount of \$914,509;
- On January 6, 2015, our debt investment in Security Monitor Holdings, LLC was repaid, wherein we received \$582,833 in cash, which included the original principal amount of the debt and all interest, as accrued; and
- On February 20, 2015, we sold our OPG Notes for €846,059 [\$953,117] in net cash proceeds.

Our Board of Directors (sometimes referred to as the “Board”) and management of the Fund (“Management”) continue to believe that current market conditions and recent portfolio performance dictate the need to pursue a more active role in the management of remaining investments and to seek liquidity events at the appropriate time to protect and enhance shareholder value. These activities include continuous monitoring and intensive reviews of portfolio company performance and expectations, providing follow-on capital when necessary, exploration of liquidity events for certain portfolio companies to position the Fund to maximize investment returns, and actively pursuing suitable new investments for the Fund.

### **Investment Objective**

To the extent we remain as a BDC and do not complete the Consolidation with MVC or one of its portfolio companies as described above, our investment objective is to maximize the total return to our stockholders in the form of current investment income and long-term capital gains by investing in the debt and equity securities of small and middle market capitalization companies that are generally not publicly traded at the time of our investment. As a result of our endeavors in the energy sector, we also seek to purchase working interests and revenue leasehold interests in oil and gas properties, although we remain open to exploring investment opportunities in a variety of other sectors, such as real estate. As we grow and develop the Fund, we intend to include investments in progressively larger enterprises.

## **Investment Strategy**

Beginning in 2006, we implemented a revised investment strategy to attempt to strike a balance between the potential for gain and the risk of loss. With respect to capital appreciation, Equus is a “growth-at-reasonable-price” investor that seeks to identify and acquire securities that meet our criteria for selling at reasonable prices. We give priority to cash producing investments wherein we invest principally in debt or preferred equity financing with the objective of generating regular interest and dividend income back to the Fund. Debt and preferred equity financing may also be used to create long-term capital appreciation through the exercise and sale of warrants received in connection with the financing. Given market conditions over the past several years and the performance of our portfolio, our Management and Board believe it prudent to continue to review alternatives to refine and further clarify the current strategies.

## **Investment Criteria**

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

*Management Competency and Ownership.* We seek to invest in companies with experienced management teams who have demonstrated a track record of successful performance. Further, we desire to invest in companies with significant management ownership. We believe that significant management ownership in small capitalization and middle market companies provides appropriate incentives and an alignment of interests for management to maximize shareholder value. In addition, we will seek to design compensation and incentive arrangements that align the interests of the portfolio company’s management with those of the Fund to enhance potential returns.

*Substantial Target Market.* We desire to focus on companies whose products or services have favorable growth potential and strong competitive positions in their respective markets. These positions may be as leadership positions within a given industry or market niche positions in which the product or service has a demonstrated competitive advantage. The market in which a potential portfolio company operates should either be sizeable or have significant growth potential.

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*History of Profitability and Favorable Growth Potential.* We target companies that have demonstrated a history of profitability or a reasonable expectation of a return to profitability in the near future.

*Ability to Provide Regular Cash Interest and Distributions.* We look for companies with strong cash flow models sufficient to provide regular and consistent interest and/or preferred dividend payments.

*Management Assistance and Substantial Equity.* Given the requirements of a BDC under the 1940 Act, we seek to invest in companies that will permit substantial managerial assistance including representation on the board of directors of the company or its equivalent. With regard to equity investments, we desire to obtain a substantial investment position in portfolio companies. This position may be as a minority shareholder with certain contractual rights and powers, or as a majority shareholder, and should otherwise allow us to have substantive input on the direction and strategies of the portfolio company.

*Plausible Exit and Potential for Appreciation.* Prior to investing in a portfolio company, we will seek to analyze potential exit strategies and pursue those investments with such strategies as may be achievable.

## **Investment Operations**

Our investment operations consist principally of the following basic activities:

*Investment Selection.* We expect that many of our investment opportunities will come from Management, members of our Board, other private equity investors, direct approaches from prospective portfolio companies and referrals from investment banks, business brokers, commercial, regional and local banks, attorneys, accountants and other members of the financial community. Subject to the approval of our Board, we 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, we undertake a due diligence review using information provided by the prospective portfolio companies and publicly available information. 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;
- Interviews with management, employees, customers and vendors of the potential portfolio company;
- 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.* We typically negotiate investments in private transactions directly with the owner or issuer of the securities acquired. Management structures the terms of a proposed investment, including the purchase price, the type of security to be purchased and our future involvement in the portfolio company's business. We seek to structure the terms of the investment to provide for the capital needs of the portfolio company while maximizing our opportunities for current income and capital appreciation. In addition, we may invest with other co-investors including private equity firms, business development companies, small business investment companies, venture capital groups, institutional investors and individual investors.

*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 companies. In several cases, officers and directors of the Fund serve as members of the governing boards of portfolio companies. Such management assistance is required of a BDC under the 1940 Act. We seek to provide guidance and management assistance with respect to such matters as capital structure, acquisitions, budgets, profit goals, corporate strategy, portfolio management and potential sale of the company or other exit strategies. 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, Management, on behalf of the Fund, may also assign staff professionals with financial or management expertise to assist portfolio company management.

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### **Follow-On Investments**

Following our initial investment, a portfolio company may request that we make follow-on investments by providing additional equity or loans needed to fully implement their business plans to develop a new line of business or to recover from unexpected business problems or other purposes. In addition, follow-on investments may be made to exercise warrants or other preferential rights granted to the Fund or otherwise to increase our position in a portfolio company. We may make follow-on investments in portfolio companies from cash on hand or borrow all or a portion of the funds required. If we are 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 our equity interest in the portfolio company may be diluted if outside equity capital is required.

### **Disposition of Investments**

The method and timing of the disposition of our investments in portfolio companies are critical to our ability to realize capital gains and minimize capital losses. We may dispose of our portfolio securities through a variety of transactions, including recapitalizations, refinancings, management buy-outs, repayments from cash flow, acquisitions of portfolio companies by a third party and outright sales of the Fund's securities in a portfolio company. In addition, we may distribute our portfolio securities in-kind to our stockholders. In structuring our investments, we endeavor 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, we seek registration rights for our 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 our current portfolio company investments, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Portfolio Securities."

### **Valuation**

On at least a quarterly basis, Management values our portfolio investments. These valuations are subject to the approval and adoption of the Board. Valuations of our 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 (which includes most of the Fund's investments) is determined through procedures established in good faith by the Board. 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.

We base our 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 or substantially declining operations, we may base a portfolio company's fair value upon the company's estimated liquidation value. Fair valuations are necessarily subjective, and our 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 increased volatility and result in a significant and rapid change in its value.

Our general intent is to hold our loans to maturity when appraising our privately held debt investments. As such, we believe that the fair value will not exceed the cost of the investment. However, in addition to the previously described analysis involving allocation of value to the debt instrument, we perform a yield analysis to determine if a debt security has been impaired.

Our Management may engage independent, third-party valuation firms to conduct independent appraisals and review Management's preliminary valuations of each privately-held investment in order to make their own independent assessment. Any third-party valuation data would be considered as one of many factors in a fair value determination. Management would then present its fair value recommendations to the Audit Committee of the Board of Directors for review. Following review and any adjustments required thereby, the Audit Committee would, in turn, recommend the fair values for all of the Fund's portfolio investments to the Board of Directors for final approval.

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To the extent that market quotations are readily available for our investments and such investments are freely transferable, we value 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), we establish our valuation by discounting the closing market price to reflect the estimated impact of illiquidity caused by such restriction. We generally hold investments in debt securities to maturity. Accordingly, we determine the fair value of debt securities on the basis of the terms of the debt securities and the financial condition of the issuer. We value certificates of deposit at their face value, plus interest accrued to the date of valuation.

Our Board reviews the valuation policies on a quarterly basis to determine their appropriateness and reserves the right to hire and from time to time utilizes independent valuation firms to review Management's valuation methodology or to conduct an independent valuation.

On a daily basis, we adjust 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. We report these amounts to Lipper Analytical Services, Inc. Our weekly and daily net asset values appear in various publications, including *Barron's* and *The Wall Street Journal*.

## **Competition**

We compete 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 our competitors are substantially larger and have considerably greater financial, technical and marketing resources than we do. Our competitors may have a lower cost of funds and many have access to funding sources that are not available to us. In addition, certain of our 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 our competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a BDC.

We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. In addition, because of this competition, we may not be able to take advantage of attractive investment opportunities and may not be able to identify and make investments that satisfy our investment objectives or meet our investment goals.

## **Properties**

Our principal executive offices are located at 700 Louisiana St., 48th Floor, Houston, Texas 77002. We believe that our office facilities are suitable and adequate for our operations as currently conducted and contemplated.

### **Business Development Company Requirements**

*Qualifying Assets.* As a BDC, we 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 our qualifying assets represent at least 70% of the value of our total assets. The principal categories of qualifying assets relevant to our 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 BDC, 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 BDC either singly or as part of a group and an affiliated person of the BDC 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, unless the total market capitalization of such issuer does not exceed \$250 million. 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 BDC'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.

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We may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC unless authorized by vote of the holders of the majority of our outstanding voting securities, as defined in the 1940 Act. Pursuant to the Plan of Reorganization announced on May 14, 2014, we intend to: (i) consummate a consolidation with MVC or one of its subsidiaries, (ii) terminate the Fund's election to be classified as a BDC under the 1940 Act, and (iii) be restructured as a publicly-traded operating company focused on the energy and/or financial services sector. Any or all of these intended developments will require an affirmative vote of the holders of a majority of our outstanding voting securities (see *Significant Developments—Plan of Reorganization* above).

To include certain securities above as qualifying assets for the purpose of the 70% test, a BDC 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. We offer to provide significant managerial assistance to each of our portfolio companies.

*Temporary Investments.* Pending investment in portfolio companies, we invest our 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 we have 70% of our total assets invested in qualifying assets or in qualified Temporary Investments for purposes of the BDC provisions of the 1940 Act.

*Leverage.* We are 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 our 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, 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.* We generally may sell our 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 our issued shares, including a majority of shares held by nonaffiliated stockholders. We 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 our stockholders. We may also issue shares at less than net asset value in payment of dividends to existing stockholders.

*No Redemption Rights.* Since we are a closed-end BDC, our stockholders have no right to present their shares to the Fund for redemption. Recognizing the possibility that our shares might trade at a discount, our Board has determined

that it would be in the best interest of our 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 we may, but are not required to, repurchase our shares (including by means of tender offers) to attempt to reduce or eliminate any discount or to increase the net asset value of our 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 require the prior approval of the SEC.

### **Regulated Investment Company Tax Status**

We operate to qualify as a "RIC" under Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"). If we qualify as a RIC and annually distribute to our stockholders in a timely manner at least 90% of our investment company taxable income, we will not be subject to federal income tax on the portion of our taxable income and capital gains we distribute to our 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 our status as a RIC, we must (i) continue to qualify as a BDC; (ii) distribute to our stockholders in a timely manner at least 90% of our investment company taxable income, as defined by the Code; (iii) derive in each taxable year at least 90% of our 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 our business of investing in such stock or securities as defined by the Code; and (iv) meet

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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 our 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 our assets and 10% of the outstanding voting securities of the issuer and (b) no more than 25% of the value of our 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 we distribute or have treated as having distributed (including amounts retained but designated as deemed distributed) in a timely manner 98% of our net capital gain income for each one-year period ending on October 31, and distribute 98.2% of our investment company net ordinary income for such calendar year (as well as any ordinary income not distributed in prior years), we will not be subject to the 4% nondeductible Federal excise tax imposed with respect to certain undistributed income of regulated investment companies.

If we fail to satisfy the 90% distribution requirement or otherwise fail to qualify as a regulated investment company in any taxable year, we will be subject to tax in such year on all of our taxable income, regardless of whether we make any distribution to our stockholders. In addition, in that case, all of our distributions to our stockholders will be characterized as ordinary income (to the extent of our current and accumulated earnings and profits). We have distributed and currently intend to distribute sufficient dividends to eliminate our investment company taxable income; however, none have been necessary in recent years.

### **Custodian**

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

### **Transfer and Disbursing Agent**

We employ American Stock Transfer & Trust Company as our transfer agent to record transfers of our shares, maintain proxy records and to process distributions. The principal business office of our transfer agent is 6201 15th Avenue, 2nd Floor, Brooklyn, NY 11219.



## Certifications

In July 2014, we submitted to the New York Stock Exchange pursuant to Section 303A.12(a) of its Listed Company Manual, an unqualified certification of our Chief Executive Officer. In addition, certifications by our 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 we operate negatively impacting our financial resources; (ii) certain of our 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 our 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) our investments in securities of privately held companies may be illiquid which could affect our ability to realize a gain; (v) our portfolio companies could default on their loans or provide no returns on its investments which could affect the Fund’s operating results; (vi) we are dependent on external financing to grow our business; (vii) our ability to retain key management personnel; (viii) an economic downturn or recession could impair our portfolio companies and therefore harm our operating results; (iv) our borrowing arrangements impose certain restrictions; (x) changes in interest rates may affect our cost of capital and net operating income; (xi) we cannot incur additional indebtedness unless the Fund maintains an asset coverage of at least 200%, which may affect

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returns to our stockholders; (xii) we may fail to continue to qualify for our pass-through treatment as a RIC which could have an effect on stockholder returns; (xiii) our 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 time with the Securities and Exchange Commission. We caution 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**

An investment in our securities involves certain risks relating to our structure and investment objectives. The risks and uncertainties described below are not the only ones facing Equus. You should carefully consider these risks, together with all of the other information included in the annual report on Form 10-K, including our financial statements and the related notes thereto.

Additional risks and uncertainties not presently known to us, or not presently deemed material by us, may also impair our operations and performance.

If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. If that happens, the trading price of our common stock could decline and you may lose all or part of your investment.

### **Risks Related to Our 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.*

We have invested and may continue to invest, in private, small and/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 effect on their business and prospects and, in turn, on our 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 regarding these companies, and investors in these 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.

*There is uncertainty regarding the value of our privately held securities.*

Our net asset value is based on the value we assign to our portfolio investments. For investments that are not listed on a securities exchange or quotation medium, we determine the value of our 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, our fair value determination may differ materially from the value that would have been used had a ready market existed for the securities. We determine the fair value of investments for which no market quotations are available based upon a methodology that we believe reaches a reasonable estimation of fair value. However, we do not necessarily apply multiple valuation metrics in reaching this determination and, in some cases, we do not obtain any third party valuations before reaching this determination. Our determinations of the fair value of our investments have a material impact on our net earnings through the recording of unrealized appreciation or depreciation of investments as well as our assessment of interest income recognition. Our net asset value could be affected materially if our determinations of the fair value of our investments differ significantly from values based on a ready market for these securities.

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***We depend upon Management for our future investment success.***

We depend upon the diligence and skill of our Management to select, structure, close and monitor our investments. Management is responsible for identifying, structuring, evaluating, monitoring, and disposing of our investments, and the services they collectively provide significantly impact our results of operations. Our future success will depend to a significant extent on the continued service and coordination of Management. Our success will depend on our ability to retain our existing Management and to recruit additional other highly qualified individuals. If we are unable to integrate new investment and management personnel, we may be unable to achieve our desired investment results.

***Management may not be able to implement our investment objective successfully.***

Our current portfolio represents a shift from a regional focus and a record of investing in basic manufacturing and service companies to an investment strategy focused in a variety of sectors such as energy and real estate. Given recent economic events and changes in our Board and Management, we have revised our strategy to be more opportunistic, emphasizing investments which generate regular cash income and distributions, with less regard for a particular industry sector. In order to implement our investment strategy, Management must analyze, conduct due diligence, invest in, monitor and sell investment interests in industries in which many of them have not previously been involved. Also, we expect that our investment strategy will continue to require Management to investigate and monitor investments that are much more broadly dispersed geographically. In addition, Management is required to provide valuations for investments in a broader range of securities, including debt securities, which may require expertise beyond that previously required. We cannot assure investors that the overall risk of their investment in the Fund will be reduced as a result of our investment strategy. If we cannot achieve our investment objective successfully, the value of your investment in our common stock could decline substantially.

***We may not realize gains from our equity investments.***

We frequently invest in the equity securities of our portfolio companies. Also, when we make a loan, we sometimes receive warrants to acquire stock issued by the borrower. Ultimately, our 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 our portfolio companies have experienced net losses in recent years or have negative net worth as of their most recent available balance sheet date. At December 31, 2014, several of our portfolio investments had estimated fair values, based upon our valuation methodologies, significantly below the initial cost of such investments. At December 31, 2014, the cost basis of our portfolio investments was \$23.2 million and our estimated fair value was \$19.6 million. Also, the market value of our equity investments may fall below our estimate of the fair value of such investments before we sell them. Given these factors, there is a risk that we will not realize gains upon the sale of those or other equity interests that we hold.

***Our holdings in Equus Energy are subject to commodity price declines endemic to oil and gas companies.***

The oil and gas business is fundamentally a commodity-based enterprise. This means that the operations and earnings of Equus Energy may be significantly affected by changes in prices of oil, gas and natural gas liquids. The prices of these products are also dependent upon local, regional and global events or conditions that affect supply and demand for the relevant commodity. In addition, the pricing of these commodities are highly dependent upon technological improvements in energy production and development, energy efficiency, and seasonal weather patterns. Moreover, as a worldwide commodity, the price of oil and natural gas is also influenced by changes in currency exchange rates, interest rates, and inflation. Equus Energy does not employ any hedging strategies in respect of its oil and gas holdings, and is therefore subject to price fluctuations resulting from these and other factors. The operational results and financial condition of Equus Energy, as well as the economic attractiveness of future capital expenditures for new drilling and recompletions, may be materially adversely affected as a result of lower oil and gas prices.

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

After our initial investment in a portfolio company, we may be called upon from time to time to provide additional funds to such company, or may have the opportunity to increase our 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. We cannot assure you that we will make, or have sufficient funds to make, any such follow-on investments. Any decision by us not to make a follow-on investment or any inability on our 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 us to increase our participation in a successful operation. A decision not to make a follow-on investment may also dilute our equity interest in, or reduce the expected yield on, our investment.

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***We have invested in a limited number of portfolio companies.***

The Fund is classified as a “non-diversified” investment company under the 1940 Act, which means we are not limited in the proportion of our assets that may be invested in the securities of a single issuer. As a matter of policy, we generally have not initially invested more than 25% of the value of our net assets in a single portfolio company. In view of the net asset value of the Fund as of December 31, 2014, however, we would expect that any new investments may exceed this percentage for the immediate future. Moreover, follow-on investments, disproportionate increases or decreases in the fair value of certain portfolio companies or sales of investments may result in more than 25% of our net assets being invested in a single portfolio company at a particular time.

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 our net asset value and the market price of our common stock to a greater extent than would be the case if we were a “diversified” company holding a greater number of investments.

***The lack of liquidity of our privately held securities may adversely affect our business***

Our 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, our ability to sell them may still be restricted because we acquired them from the issuer in “private placement” transactions or because we may be deemed to be an affiliate of the issuer. We will not be able to sell these securities publicly without the expense and time required to register the securities under the Securities Act and applicable state securities laws, unless an exemption from such registration requirements is available. In addition, contractual or practical limitations may restrict our ability to liquidate our securities in portfolio companies because those securities are privately held and we may own a relatively large percentage of the issuer’s outstanding securities. Sales also may be limited by market conditions, which may be unfavorable for sales of securities of particular issuers or generally. The illiquidity of our investments may preclude or delay any disposition of such securities, which may make it difficult for us to obtain cash equal to the value at which we record our investments if the need arises.

***We have limited public information regarding the companies in which we invest.***

Except for our holdings MVC, our portfolio consists entirely of securities issued by privately-held companies. There is generally little or no publicly available information about such companies, and we must rely on the diligence of Management to obtain the information necessary for our decision to invest in them and in order to monitor them effectively. We cannot assure you that such diligence efforts will uncover all material information about such privately held businesses necessary to make fully informed investment decisions.

***Our 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 our investment as compared to the overall change in the enterprise value of a portfolio company.

Many of our 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, our 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 our portfolio companies, as well as the value of our 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 our portfolio companies to service their floating rate debt and on their profits.

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

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***The use of leverage may adversely affect our performance.***

We may utilize leverage for the Fund or its subsidiaries by borrowing or issuing preferred stock or short-term debt securities. Borrowings and other capital generated from leverage will result in lenders and other creditors with fixed dollar claims on our assets that are superior to the claims of our common shareholders. If the value of our assets increases, then leveraging would cause the net asset value attributable to our common stock to increase more sharply than it would have had we not leveraged. Conversely, if the value of our assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our income in excess of interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our income would cause net income to decline more sharply than it would have had we not borrowed. Leverage is generally considered a speculative investment technique.

***Our business depends on external financing.***

Our business requires a substantial amount of cash to operate. We may borrow funds to pay contingencies or expenses or to make investments, to maintain our pass-through tax status as a RIC under Subchapter M of the Code. We are permitted under the 1940 Act to borrow if, immediately after the borrowing, we have an asset coverage ratio of at least 200%. That is, we may borrow an amount equal to as much as 50% of the fair value of our total assets (including investments made with borrowed funds). The amount and nature of any such borrowings depend upon a number of factors over which we have no control, including general economic conditions, conditions in the financial markets and the impact of the financing on the tax treatment of our stockholders. The use of leverage, even on a short-term basis, could have the effect of magnifying increases or decreases in our net asset value.

While the “spread” between the current yields on our investments and the cost of any loan would augment the return to our stockholders, if the spread narrows (because of an increase in the cost of debt or insufficient income on our investments), distributions to our stockholders could be adversely affected. This may render us unable to meet our obligations to our lenders, which might then require us to liquidate some or all of our investments. There can be no assurance that we would realize full value for our investments or recoup all of our capital if we needed to liquidate our portfolio investments.

Many financial institutions are unwilling to lend against a portfolio of illiquid, private securities. The make-up of our portfolio has made it more difficult for us to borrow at the level and on the terms that we desire. Our borrowings have historically consisted of a revolving line of credit, the proceeds of which we may use 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 us to achieve adequate diversification to maintain our pass-through tax status as a RIC. Although we believe the Fund’s liquidity is sufficient for our operating expenses for the next twelve months, we could be wrong. If we are wrong, we would have to obtain capital from other sources to pay Fund expenses, which could involve selling one or more of our portfolio holdings at an inopportune time and at a price that may be less than would



be received if such holding were sold in a more competitive and orderly manner.

The costs of borrowing money may exceed the income from the portfolio securities we purchase with the borrowed money. We 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 our ability to make distributions on our common stock. Our failure to distribute a sufficient portion of our net investment income and net realized capital gains could result in a loss of pass-through tax status or subject us 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), we may be required to sell a portion of our investments when it is disadvantageous to do so. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

***Our net assets have declined substantially since 2010 and we have had net investment losses in four out of the past five years.***

Our net assets have declined from \$38.0 million as of December 31, 2010 to \$36.2 million as of December 31, 2014. Moreover, we have had net investment losses in four out of the past five years, with a net investment loss of \$2.4 million for the year ended December 31, 2014. We cannot assure you that we will be able to increase our net assets or generate net investment income. If we fail to increase the Fund’s net assets or generate net investment income, such failure will likely have a material adverse effect upon the Fund, its results of operation, and its financial condition. You could lose all or a substantial amount of your investment in the Fund as a result.

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***We may not be able to recommence our managed distribution policy and you might not receive dividends on your shares.***

On March 24, 2009, we announced a suspension of our managed distribution policy and payment of quarterly dividends for an indefinite period, following the distribution of the first quarter 2009 dividend 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. We subsequently undertook certain changes in our Board and Management. These changes have been pursued, in part, with the objective of increasing the number of attractive investment opportunities to us and revising our investment strategy to include more recurrent cash income producing investments, all of which could ultimately result in the resumption of our managed distribution policy at some time in the future. The implementation of these revisions to our investment strategy and the recurrent generation of cash income from our investments, however, cannot be guaranteed. If we were unable to resume our managed distribution policy and were further unable to profitably sell or otherwise dispose of our portfolio company investments, you might not receive dividends on your shares.

***We operate in a highly competitive market for investment opportunities***

We compete 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 our competitors are substantially larger and have considerably greater financial resources than we do, and some may be subject to different and frequently less stringent regulation. As our portfolio size increases, we expect that some of our investments will be larger. We believe that we 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 us. In addition, some of our 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, we may not be able to take advantage of attractive investment opportunities from time to time. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations.

***Our investments in foreign securities may involve significant risks in addition to the risks inherent in U.S. investments.***

Our investment strategy contemplates that a portion of our investments may be made in securities of foreign companies, such as our holdings in OPG. Investing in foreign companies may expose us 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 our 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. We may employ hedging techniques to minimize these risks, but we can offer no assurance that we will, in fact, hedge currency risk or that, if we do, such strategies will be effective.

***An economic downturn could affect our operating results.***

An economic downturn may have a particularly adverse effect upon small and medium-sized companies, which are our primary market for investments. During periods of volatile economic conditions such as presently exists generally in the United States, these companies often experience decreased revenues, financial losses, difficulty in obtaining access to financing and increased funding costs. During such periods, these companies also may 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 our investments in these companies to decline. In addition, during periods of adverse economic conditions, we may have difficulty accessing financial markets, which could make it more difficult or impossible for us to obtain funding for additional investments. Any of these events could have a material adverse effect on our business, financial condition and results of operations.

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***We may experience fluctuations in our quarterly results.***

We may experience fluctuations in our 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 we encounter competition in our markets, the ability to find and close suitable investments and general economic conditions. The volatility of our results is exacerbated by our relatively small number of investments. As a result of these factors, you should not rely on our results for any period as being indicative of performance in future periods.

***The due diligence process that we undertake in connection with our investments may not reveal all facts that may be relevant in connection with an investment.***

Before making our investments, we conduct due diligence that we deem 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, we evaluate a number of important business, financial, tax, accounting, environmental and legal issues in determining whether or not to proceed with an investment. Our 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, we are required to rely on resources available to us, 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, we cannot assure you that the due diligence investigation that we 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. We also cannot assure you that such an investigation will result in an investment being successful.

**Risks Related to Our Business and Structure**

***Our ability to invest in private companies may be limited in certain circumstances.***

If we are to maintain our status as a BDC, we 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 our total assets are qualifying assets. A principal category of qualifying assets relevant to our business is securities purchased in transactions not involving any public

offer from issuers that are eligible portfolio companies under the 1940 Act. 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.

***Any failure on our part to maintain the Fund's status as a BDC could reduce our operating flexibility.***

If we do not maintain the Fund's status as a BDC, we might be regulated as a closed-end investment company under the 1940 Act, which would subject us to substantially more regulatory restrictions under the 1940 Act. This could impose tighter limitations on Equus in terms of the use of leverage and transactions with affiliated entities. Such developments could correspondingly decrease our operating flexibility.

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

To remain entitled to the tax benefits accorded to RICs under the Code, we must meet certain income source, asset diversification and annual distribution requirements. To qualify as a RIC, we must derive each taxable year at least 90% of our 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 our 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 we distribute at least 90% of our ordinary net taxable income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, to our stockholders on an annual basis. As discussed above in "Our business is dependent on external financing," we historically have borrowed funds necessary to make qualifying investments to satisfy the Subchapter M diversification requirements. If we fail to satisfy such diversification requirements and cease to qualify for conduit tax treatment, we will be subject to income tax on our income and gains and will not be permitted to deduct distributions paid to stockholders. In addition, our distributions will be taxable as dividends to the extent paid from earnings and profits. We may also cease to qualify as a RIC, or be subject to income tax and/or a 4% excise tax, if we fail to distribute a sufficient portion of our net investment income and net realized capital gains. The loss of our RIC qualification would have a material adverse effect on the total return, if any, obtainable from an investment in our common stock.

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***Because we intend to distribute substantially all of our income and net realized capital gains to our stockholders, we will need additional capital to finance our growth.***

In order to qualify as a RIC, to avoid payment of excise taxes and to minimize or avoid payment of income taxes, we intend to distribute to our stockholders substantially all of our net ordinary income and realized net capital gains except for certain net long-term capital gains (which we may retain, pay applicable income taxes with respect thereto, and elect to treat as deemed distributions to our stockholders). As a BDC, we are generally required to meet a coverage ratio of total assets to total senior securities, which includes all of our borrowings and any preferred stock we may issue in the future, of at least 200%. This requirement limits the amount that we may borrow. Because we will continue to need capital to grow our investment portfolio, this limitation may prevent us from incurring debt and require us to issue additional equity at a time when it may be disadvantageous to do so. We cannot assure you that debt and equity financing will be available to us on favorable terms, or at all, and debt financings may be restricted by the terms of any of our outstanding borrowings. In addition, as a BDC, except for limited situations such as this offering, we are generally not permitted to issue equity securities priced below net asset value without stockholder approval. If additional funds are not available to us, we could be forced to curtail or cease new lending and investment activities, and our net asset value could decline.

***Our Board of Directors may change our investment objective, operating policies and strategies without prior notice or stockholder approval.***

Our Board of Directors has the authority to modify or waive certain of our operating policies and strategies without prior notice (except as required by the 1940 Act) and without stockholder approval. However, absent stockholder approval, we may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC. We cannot predict the effect any changes to our current operating policies and strategies would have on our business, operating results and value of our stock. Nevertheless, any such effects may adversely affect our business and impact our ability to make distributions.

### **Risks Related to Our Operation as a BDC**

***Our ability to enter into transactions with our affiliates is restricted.***

We are prohibited under the 1940 Act from participating in certain transactions with certain of our affiliates without the prior approval of our independent directors and, in some cases, the SEC. Any person that owns, directly or indirectly, 5% or more of our outstanding voting securities is our affiliate for purposes of the 1940 Act, and we generally are prohibited from buying or selling any security from or to such affiliate, absent the prior approval of our independent directors. The 1940 Act also prohibits certain “joint” transactions with certain of our affiliates, which could

include investments in the same portfolio company (whether at the same or different times), without prior approval of our independent directors and, in some cases, the SEC. If a person acquires more than 25% of our voting securities, we are prohibited from buying or selling any security from or to such person or certain of that person's affiliates, or entering into prohibited joint transactions with such persons, absent the prior approval of the SEC. Similar restrictions limit our ability to transact business with our officers or directors or their affiliates.

***Regulations governing our operation as a BDC affect our ability to, and the way in which we, raise additional capital.***

Our business requires a substantial amount of additional capital. We may acquire additional capital from the issuance of senior securities or other indebtedness, the issuance of additional shares of our common stock or from securitization transactions. However, we may not be able to raise additional capital in the future on favorable terms or at all. We may issue debt securities or preferred securities, which we refer to collectively as "senior securities," and we may borrow money from banks or other financial institutions, up to the maximum amount permitted by the 1940 Act. The 1940 Act permits us to issue senior securities or incur indebtedness only in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such issuance or incurrence. Our ability to pay dividends or issue additional senior securities would be restricted if our asset coverage ratio were not at least 200%. If the value of our assets declines, we may be unable to satisfy this test. If that happens, we may be required to liquidate a portion of our investments and repay a portion of our indebtedness at a time when such sales may be disadvantageous.