

EQUUS TOTAL RETURN, INC.  
Form 10-Q  
November 10, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2016

or

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

For the transition period to

Commission File Number 814-00098

**EQUUS TOTAL RETURN, INC.**

(Exact name of registrant as specified in its charter)

<b>Delaware</b> (State or other jurisdiction of incorporation or organization)	<b>76-0345915</b> (I.R.S. Employer Identification No.)
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**700 Louisiana St., 48<sup>th</sup> Floor**

<b>Houston, Texas</b> (Address of principal executive offices)	<b>77002</b> (Zip Code)
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(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

**Registrant's telephone number, including area code: (713) 529-0900**

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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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company. Yes No

There were 12,673,646 shares of the registrant’s common stock, \$.001 par value, outstanding, as of November 10, 2016.

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EQUUS TOTAL RETURN, INC.

(A Delaware Corporation)

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Table of Contents**EQUUS TOTAL RETURN, INC.****BALANCE SHEETS****(Unaudited)****Part I. Financial Information****Item 1. Financial Statements**

	September 30, 2016	December 31, 2015
(in thousands, except per share amounts)		
Assets		
Investments in portfolio securities at fair value:		
Control investments (cost at \$10,050 and \$10,050 respectively)	\$5,463	\$5,715
Affiliate investments (cost at \$350 and \$350 respectively)	15,400	9,600
Non-affiliate investments - related party (cost at \$5,949 and \$5,698 respectively)	3,824	3,159
Non-affiliate investments (cost at \$2,978 and \$915 respectively)	2,978	915
Total investments in portfolio securities at fair value	27,665	19,389
Temporary cash investments	29,998	15,000
Cash and cash equivalents	12,617	17,036
Restricted cash	300	150
Accounts receivable from investments	611	614
Accrued interest receivable	428	128
Accrued dividend receivable	—	130
Accounts receivable and other	117	83
Total assets	71,736	52,530
Liabilities and net assets		
Accounts payable and accrued liabilities	127	36
Accounts payable to related parties	105	186
Borrowing under margin account	29,998	15,000
Total liabilities	30,230	15,222
Commitments and contingencies (See Note 2)		
Net assets	\$41,506	\$37,308
Net assets consist of:		
Common stock, par value	\$13	\$13
Capital in excess of par value	54,217	54,226
Undistributed net investment losses	(21,062)	(19,307)
Undistributed net capital gains	—	—

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Unrealized appreciation of portfolio securities, net	10,463	4,915
Unrealized depreciation of portfolio securities - related party, net	(2,125 )	(2,539 )
Total net assets	\$41,506	\$37,308
Shares of common stock issued and outstanding, \$.001 par value, 50,000 shares authorized	12,674	12,674
Shares of preferred stock issued and outstanding, \$.001 par value, 5,000 shares authorized	—	—
Net asset value per share	\$3.27	\$2.94

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

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Table of Contents**EQUUS TOTAL RETURN, INC.****STATEMENTS OF OPERATIONS****(Unaudited)**

	Three Months Ended		Nine Months Ended	
(in thousands, except per share amounts)	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Investment income:				
Interest and dividend income:				
Non-affiliate investments - related party	\$61	\$56	\$121	111
Non-affiliate investments	128	33	428	109
Total interest and dividend income	189	89	549	220
Interest from temporary cash investments	2	2	7	4
Total investment income	191	91	556	224
Expenses:				
Compensation expense	257	215	791	1,078
Professional fees	292	81	809	517
Director fees and expenses	58	68	323	279
General and administrative expense	108	76	270	252
Mailing, printing and other expenses	27	17	96	106
Taxes	15	4	15	29
Interest expense	4	—	7	1
Total expenses	761	461	2,311	2,262
Net investment loss	(570 )	(370 )	(1,755 )	(2,038 )
Net realized gain (loss):				
Control investments	—	—	—	(2,850 )
Non-affiliate investments	—	—	—	372
Temporary cash investments	(6 )	—	(9 )	(5 )
Net realized loss	(6 )	—	(9 )	(2,483 )
Net unrealized appreciation (depreciation) of portfolio securities:				
End of period	10,463	4,815	10,463	4,815
Beginning of period	8,113	3,942	4,915	(1,840 )
Net change in unrealized appreciation (depreciation) of portfolio securities	2,350	873	5,548	6,655
Net unrealized depreciation of portfolio securities - related party:				
End of period	(2,125 )	(2,408 )	(2,125 )	(2,408 )
Beginning of period	(2,240 )	(1,572 )	(2,539 )	(1,725 )
Net change in unrealized depreciation of portfolio securities - related party	115	(836 )	414	(683 )
Net increase (decrease) in net assets resulting from operations	\$1,889	\$(333 )	\$4,198	\$1,451

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Net increase (decrease) in net assets resulting from operations per share:				
Basic and diluted	\$0.16	\$(0.03 )	\$0.33	\$0.11
Weighted average shares outstanding:				
Basic and diluted	12,674	12,674	12,674	12,674

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

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**EQUUS TOTAL RETURN, INC.**

**STATEMENTS OF CHANGES IN NET ASSETS**

**(Unaudited)**

(in thousands)	Nine months ended September 30,	
	2016	2015
Net increase in net assets resulting from operations	\$4,198	\$1,451
Net assets at beginning of period	37,308	36,201
Net assets at end of period	\$41,506	\$37,652

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

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Table of Contents**EQUUS TOTAL RETURN, INC.****STATEMENTS OF CASH FLOWS****(Unaudited)**

(in thousands)	Nine months ended September 30,	
	2016	2015
Reconciliation of increase in net assets resulting from operations to net cash (used in) provided by operating activities:		
Net increase in net assets resulting from operations	\$4,198	\$1,451
Adjustments to reconcile net increase in net assets resulting from operations to net cash (used in) provided by operating activities:		
Net realized loss	9	2,483
Net change in unrealized appreciation of portfolio securities	(5,548 )	(6,655 )
Net change in unrealized depreciation of portfolio securities - related party	(414 )	683
Changes in operating assets and liabilities:		
Purchase of portfolio securities	(2,000 )	—
Net proceeds from dispositions of portfolio securities	—	372
Principal payments received from portfolio securities	—	4,255
Purchases of temporary cash investments, net	(15,157)	(7 )
Decrease in accounts receivable from investments	3	—
Increase in accrued interest receivable	(363 )	(357 )
Increase in accrued dividend receivable	(121 )	—
Increase in accounts receivable and other	(34 )	(11 )
(Increase) decrease in accounts payable and accrued liabilities	91	(653 )
Decrease (increase) in accounts payable to related parties	(81 )	22
Net cash (used in) provided by operating activities	(19,417)	1,583
Cash flows from financing activities:		
Borrowings under margin account	72,983	15,001
Repayments under margin account	(57,985)	(14,999)
Net cash provided by financing activities	14,998	2
Net (decrease) increase in cash and cash equivalents	(4,419 )	1,585
Cash and cash equivalents at beginning of period	17,036	15,697
Cash and cash equivalents at end of period	\$12,617	\$17,282
Non-cash operating and financing activities:		
Accrued interest or dividends exchanged for portfolio securities	\$63	\$915
Accrued dividends exchanged for portfolio securities - related party	\$251	\$165
Supplemental disclosure of cash flow information:		
Interest paid	\$5	\$1
Income taxes paid	\$15	\$29

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

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Table of Contents**EQUUS TOTAL RETURN, INC.****SUPPLEMENTAL INFORMATION—SELECTED PER SHARE DATA AND RATIOS****(Unaudited)**

	Nine months ended September 30,	
	2016	2015
Investment income	\$0.04	\$0.02
Expenses	0.18	0.18
Net investment loss	(0.14 )	(0.16 )
Net realized loss	—	(0.20 )
Net change in unrealized appreciation	0.44	0.52
Net change in unrealized depreciation - related party	0.03	(0.05 )
Net increase in net assets	0.33	0.11
Net assets at beginning of period	2.94	2.86
Net assets at end of period, basic and diluted	\$3.27	\$2.97
Weighted average number of shares outstanding during period, in thousands	12,674	12,674
Market price per share:		
Beginning of period	\$1.79	\$2.10
End of period	\$1.86	\$1.75
Selected information and ratios:		
Ratio of expenses to average net assets	5.86 %	6.13 %
Ratio of net investment loss to average net assets	(4.45 %)	(5.52 %)
Ratio of net increase in net assets resulting from operations to average net assets	10.65 %	3.93 %
Total return on market price <sup>(1)</sup>	3.91 %	(16.67 %)

<sup>(1)</sup> Total return = [(ending market price per share - beginning price per share) / beginning market price per share].

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

Table of Contents**EQUUS TOTAL RETURN, INC.****SCHEDULE OF INVESTMENTS****SEPTEMBER 30, 2016****(Unaudited)***(in thousands, except share data)*

Name and Location of Portfolio Company	Industry	Date of Initial Investment	Investment	Principal	Cost of Investment	Fair Value <sup>(1)</sup>
Control Investments: Majority-owned (3):						
Equus Energy, LLC Houston, TX	Energy	December 2011	Member interest (100%)		\$ 7,050	\$ 5,250
Equus Media Development Company, LLC Houston, TX	Media	January 2007	Member interest (100%)		3,000	213
Total Control Investments: Majority-owned (represents 9.5% of total investments at fair value)					<b>\$ 10,050</b>	<b>\$ 5,463</b>
Affiliate Investments (4):						
PalletOne, Inc. Bartow, FL	Shipping products and services	October 2001	350,000 shares of common stock (18.7%)		\$ 350	\$ 15,400
Total Affiliate Investments (represents 26.7% of total investments at fair value)					<b>\$ 350</b>	<b>\$ 15,400</b>
Non-Affiliate Investments - Related Party (less than 5% owned):						
MVC Capital, Inc. Purchase, NY	Financial services	May 2014	461,292 shares of common stock (1.7%)		\$ 5,949	\$ 3,824
Total Non-Affiliate Investments - Related Party (represents 6.6% of total investments at fair value)					<b>\$ 5,949</b>	<b>\$ 3,824</b>
Non-Affiliate Investments (less than 5% owned):						
5 <sup>TH</sup> Element Tracking, LLC Boston, MA	Business products and services	January 2015	14% promissory note due 10/16 <sup>(2)</sup>	\$ 965	\$ 965	\$ 965
Biogenic Reagents, LLC Minneapolis, MN	Energy	January 2016	16% promissory note due 6/16 <sup>(2)</sup>	2,013	2,013	2,013
					<b>\$ 2,978</b>	<b>\$ 2,978</b>

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Total Non-Affiliate Investments (represents 5.2% of total investments at fair value)			
Total Investment in Portfolio Securities		\$ 19,327	\$ 27,665
Temporary Cash Investments			
U.S. Treasury Bill	Government	October 2016 UST 0% 10/16	\$ 30,000
			\$ 30,000
			\$ 29,998
Total Temporary Cash Investments (represents 52.0% of total investments at fair value)			
			\$ 30,000
			\$ 29,998
Total Investments			
			\$ 49,327
			\$ 57,663

(1) See Note 3 to the financial statements, Valuation of Investments.

(2) Income-producing.

(3) Majority owned investments are generally defined under the Investment Company Act of 1940 as companies in which we own more than 50% of the voting securities of the company.

(4) Affiliate investments are generally defined under the Investment Company Act of 1940 as companies in which we own at least 5% but not more than 25% 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 INVESTMENTS – (Continued)****SEPTEMBER 30, 2016****(Unaudited)**

Except for our holding of shares of MVC Capital, Inc. (“MVC”), all of our portfolio securities are restricted from public sale without prior registration under the Securities Act of 1933 (hereafter, the “Securities Act”). We negotiate certain aspects of the method and timing of the disposition of our investment in each portfolio company, including registration rights and related costs.

We may invest up to 30% of our assets in non-qualifying portfolio investments, as permitted by the Investment Company Act of 1940 (hereafter, the “1940 Act”). Specifically, we may invest up to 30% of our assets in entities that are not considered “eligible portfolio companies” (as defined in the 1940 Act), including companies located outside of the United States, entities that are operating pursuant to certain exceptions under the 1940 Act, and publicly-traded entities with a market capitalization exceeding \$250 million. As of September 30, 2016, except for our holding of shares of MVC, all of our investments are in enterprises that are considered eligible portfolio companies under the 1940 Act. We provide significant managerial assistance to portfolio companies that comprise 27.0% of the total value of the investments in our portfolio securities as of September 30, 2016.

Our investments in portfolio securities consist of the following types of securities as of September 30, 2016 (in thousands):

Type of Securities	Cost	Fair Value	Fair Value as Percentage of <u>Net Assets</u>
Limited liability company investments	\$10,050	\$5,463	13.2 %
Secured and subordinated debt	2,978	2,978	7.2 %
Common stock	6,299	19,224	46.3 %
Total	\$19,327	\$27,665	66.7 %

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The following is a summary by industry of the Fund's investments in portfolio securities as of September 30, 2016 (in thousands):

Industry	Fair Value	Fair Value as Percentage of
		<b><u>Net Assets</u></b>
Shipping products and services	\$15,400	37.1 %
Energy	7,263	17.5 %
Financial services	3,824	9.2 %
Business products and services	965	2.3 %
Media	213	0.6 %
Total	\$27,665	66.7 %

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

Table of Contents**EQUUS TOTAL RETURN, INC.****SCHEDULE OF INVESTMENTS****DECEMBER 31, 2015****(Unaudited)***(in thousands, except share data)*

<b>Name and Location of Portfolio Company Control</b>	<b>Industry</b>	<b>Date of Initial Investment</b>	<b>Investment</b>	<b>Principal</b>	<b>Cost of Investment</b>	<b>Fair Value<sup>(1)</sup></b>
<b>Investments: Majority-owned (3):</b>						
Equus Energy, LLC Houston, TX	Energy	December 2011	Member interest (100%)	\$	7,050	\$ 5,500
Equus Media Development Company, LLC Houston, TX	Media	January 2007	Member interest (100%)		3,000	215
<b>Total Control Investments: Majority-owned (represents 16.6% of total investments at fair value)</b>				<b>\$</b>	<b>10,050</b>	<b>\$ 5,715</b>
<b>Affiliate Investments (4):</b>						
PalletOne, Inc. Bartow, FL	Shipping products and services	October 2001	350,000 shares of common stock (18.8%)	\$	350	\$ 9,600
<b>Total Affiliate Investments (represents 27.9% of total investments at fair value)</b>				<b>\$</b>	<b>350</b>	<b>\$ 9,600</b>
<b>Non-Affiliate Investments - Related Party (less than 5% owned):</b>						
MVC Capital, Inc. Purchase, NY	Financial services	September 2014	428,662 shares of common stock (1.7%)	\$	5,698	\$ 3,159
<b>Total Non-Affiliate Investments - Related Party (represents 9.2% of total investments at fair value)</b>				<b>\$</b>	<b>5,698</b>	<b>\$ 3,159</b>
<b>Non-Affiliate Investments (less than 5% owned):</b>						
5 <sup>TH</sup> Element Tracking, LLC Boston, MA	Business products and services	January 2015	14% promissory note due 1/16 <sup>(2)</sup>	\$ 915	\$ 915	\$ 915
<b>Total Non-Affiliate Investments (represents 2.7% of total investments at fair value)</b>				<b>\$</b>	<b>915</b>	<b>\$ 915</b>
<b>Total Investment in Portfolio Securities</b>				<b>\$</b>	<b>17,013</b>	<b>\$ 19,389</b>

**Temporary Cash Investments**

U.S. Treasury Bill	Government	December 2015	UST 0% 1/16	\$ 15,000	\$ 15,000	\$ 15,000
<b>Total Temporary Cash Investments (represents 43.6% of total investments at fair value)</b>					<b>\$ 15,000</b>	<b>\$ 15,000</b>
<b>Total Investments</b>					<b>\$ 32,013</b>	<b>\$ 34,389</b>

(1) See Note 3 to the financial statements, Valuation of Investments.

(2) Income-producing.

(3) Majority owned investments are generally defined under the Investment Company Act of 1940 as companies in which we own more than 50% of the voting securities of the company.

(4) Affiliate investments are generally defined under the Investment Company Act of 1940 as companies in which we own at least 5% but not more than 25% 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 INVESTMENTS – (Continued)****DECEMBER 31, 2015****(Unaudited)**

Except for our holding of shares of MVC, all of our portfolio securities are restricted from public sale without prior registration under the Securities Act. We negotiate certain aspects of the method and timing of the disposition of our investment in each portfolio company, including registration rights and related costs.

We may invest up to 30% of our assets in non-qualifying portfolio investments, as permitted by the 1940 Act. Specifically, we may invest up to 30% of our assets in entities that are not considered “eligible portfolio companies” (as defined in the 1940 Act), including companies located outside of the United States, entities that are operating pursuant to certain exceptions under the 1940 Act, and publicly-traded entities with a market capitalization exceeding \$250 million. As of December 31, 2015, except for our shares of MVC, all of our investments are in enterprises that are considered eligible portfolio companies under the 1940 Act. We provide significant managerial assistance to portfolio companies that comprise 29.5% of the total value of the investments in our portfolio securities as of December 31, 2015.

Our investments in portfolio securities consist of the following types of securities as of December 31, 2015 (in thousands):

<b>Type of Securities</b>	<b>Cost</b>	<b>Fair Value</b>	<b>Fair Value as</b>	
			<b>Percentage of</b>	<b>Net Assets</b>
Limited liability company investments	\$10,050	\$5,715	15.3	%
Secured and subordinated debt	915	915	2.5	%
Common stock	6,048	12,759	34.2	%
Total	\$17,013	\$19,389	52.0	%

The following is a summary by industry of the Fund’s investments in portfolio securities as of December 31, 2015 (in thousands):

<b>Industry</b>	<b>Fair Value</b>	<b>Fair Value as Percentage of</b>	
		<b>Net Assets</b>	
Shipping products and services	\$9,600	25.7	%
Energy	5,500	14.7	%
Financial services	3,159	8.5	%
Business products and services	915	2.5	%
Media	215	0.6	%
Total	\$19,389	52.0	%

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

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2016**

(Unaudited)

**(1) Description of Business and Basis of Presentation**

**Description of Business** - Equus Total Return, Inc. (“we,” “us,” “our,” “Equus” the “Company” and 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. Our shares trade on the New York Stock Exchange under the symbol ‘EQS’. 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 subordinate 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 team (hereinafter, “Management”) and Board of Directors believe it prudent to continue to review alternatives to refine and further clarify the current strategies.

We elected to be treated as a business development company (“BDC”) under the 1940 Act. We currently qualify as a regulated investment company (“RIC”) for federal income tax purposes and, therefore, are not required to pay corporate income taxes on any income or gains that we distribute to our stockholders. We have certain wholly owned taxable subsidiaries (“Taxable Subsidiaries”) each of which holds one or more portfolio investments listed on our Schedules of Investments. The purpose of these Taxable Subsidiaries is to permit us to hold certain income-producing investments or portfolio companies organized as limited liability companies, or LLCs, (or other forms of pass-through entities) and still satisfy the RIC tax requirement that at least 90% of our gross revenue for income tax purposes must consist of investment income. Absent the Taxable Subsidiaries, a portion of the gross income of these income-producing

investments or of any LLC (or other pass-through entity) portfolio investment, as the case may be, would flow through directly to us for the 90% test. To the extent that such income did not consist of investment income, it could jeopardize our ability to qualify as a RIC and, therefore, cause us to incur significant federal income taxes. The income of the LLCs (or other pass-through entities) owned by Taxable Subsidiaries is taxed to the Taxable Subsidiaries and does not flow through to us, thereby helping us preserve our RIC status and resultant tax advantages. We do not consolidate the Taxable Subsidiaries for income tax purposes and they may generate income tax expense because of the Taxable Subsidiaries' ownership of the portfolio companies. We reflect any such income tax expense on our Statements of Operations.

**Basis of Presentation** - In accordance with Article 6 of Regulation S-X under the Securities Act of 1933 and the Securities Exchange Act of 1934, we do not consolidate portfolio company investments, including those in which we have a controlling interest. Our interim unaudited financial statements were prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, for interim financial information and in accordance with the requirements of reporting on Form 10-Q and Article 10 of Regulation S-X, under the Securities Exchange Act of 1934, as amended. Accordingly, they are unaudited and exclude some disclosures required for annual financial statements. Management believes it has made all adjustments, consisting solely of normal recurring accruals, necessary for the fair presentation of these interim financial statements.

The results of operations for the nine months ended September 30, 2016 are not necessarily indicative of results that ultimately may be achieved for the remainder of the year. The interim unaudited financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in the Fund's Annual Report on Form 10-K for the fiscal year ended December 31, 2015, as filed with the Securities and Exchange Commission ("SEC").



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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2016**

(Unaudited)

**(2) Liquidity and Financing Arrangements**

**Liquidity** - There are several factors that may materially affect our liquidity during the reasonably foreseeable future. We view this period as the twelve month period from the date of the financial statements in this Form 10-Q, *i.e.*, the period through September 30, 2017. We are evaluating the impact of current market conditions on our portfolio company valuations and the ability of these companies to provide current income. We have followed valuation techniques in a consistent manner; however, we are cognizant of current market conditions that might affect future valuations of portfolio securities. We believe that our operating cash flow and cash on hand will be sufficient to meet operating requirements and to finance routine follow-on investments, if any, through the next twelve months.

**Cash and Cash Equivalents** - As of September 30, 2016, we had cash and cash equivalents of \$12.6 million. We had \$27.7 million of our net assets of \$41.5 million invested in portfolio securities. We also had \$30.3 million of restricted cash and temporary cash investments, including primarily the proceeds of a quarter-end margin loan that we incurred to maintain the diversification requirements applicable to a RIC to maintain our pass-through tax treatment. 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 were sold on October 3, 2016 and we subsequently repaid this margin loan, plus interest.

As of December 31, 2015, we had cash and cash equivalents of \$17.0 million. We had \$19.4 million of our net assets of \$37.3 million invested in portfolio securities. We also had \$15.1 million of temporary cash investments and restricted cash, including primarily the proceeds of a quarter-end margin loan that we incurred to maintain the diversification requirements applicable to a RIC. Of this amount, \$15.0 million was invested in U.S. Treasury bills and \$0.1 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 were sold on January 4, 2016 and we subsequently repaid this margin loan, plus interest.

**Dividends** - We will pay out net investment income and/or realized capital gains, if any, on an annual basis as required under the 1940 Act.

**Investment Commitments** - As of September 30, 2016, we had no outstanding commitments to our portfolio company investments.

Under certain circumstances, we may be called on to make follow-on investments in certain portfolio companies. If we do not have sufficient funds to make follow-on investments, the portfolio company in need of the investment may be negatively impacted. Also, our equity interest in the estimated fair value of the portfolio company could be reduced.

**RIC Borrowings, Restricted Cash and Temporary Cash Investments** - We may periodically borrow sufficient funds to maintain the Fund's RIC status by utilizing a margin account with a securities brokerage firm. We cannot assure you that such arrangement will be available in the future. If we are unable to borrow funds to make qualifying investments, we may no longer qualify as a RIC. We 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 materially adverse to us and our stockholders.

As of September 30, 2016, we borrowed \$30.0 million to maintain our RIC status by utilizing a margin account with a securities brokerage firm. We collateralized such borrowings with restricted cash and temporary cash investments in U.S. Treasury bills of \$30.3 million.

As of December 31, 2015, we borrowed \$15.0 million to maintain our RIC status by utilizing a margin account with a securities brokerage firm. We collateralized such borrowings with restricted cash and temporary cash investments in U.S. Treasury bills of \$15.1 million.

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(Unaudited)

**Certain Risks and Uncertainties** - Market and economic volatility which has become endemic in the past few years has resulted in a relatively limited amount of available debt financing for small and medium-sized companies such as Equus and its portfolio companies. Such debt financing generally has shorter maturities, higher interest rates and fees, and more restrictive terms than debt facilities available in the past. In addition, during these years and continuing into the first nine months of 2016, the price of our common stock remained well below our net asset value, thereby making it undesirable to issue additional shares of our common stock below net asset value. Because of these challenges, our near-term strategies shifted from originating debt and equity investments to preserving liquidity necessary to meet our operational needs. Key initiatives that we have previously undertaken to provide necessary liquidity include monetizations, the suspension of dividends and the internalization of management. Although we cannot assure you that such initiatives will be sufficient, we believe we have sufficient liquidity to meet our operating requirements for the remainder of 2016 and the first nine months of 2017.

**(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 GAAP requires us to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Although we believe the estimates and assumptions used in preparing these financial statements and related notes are reasonable in light of known facts and circumstances, actual results could differ from those estimates.

**Valuation of Investments** - We follow ASC Topic 820 for measuring fair value. Prior to our election to become a BDC, we also followed the guidance in ASC Topic 820 in disclosing the fair value reported for all financial instruments that were either impaired or available for sale securities, using the definitions provided in Accounting Standards Codification Topic 320, "Investments – Debt and Equity Securities" ("ASC Topic 320"). Fair value is 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 and sets out a fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Inputs are broadly defined under ASC Topic 820 as assumptions market participants would use in pricing an asset or liability. The three levels of the fair value hierarchy under ASC Topic 820 are described below:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly; and fair value is determined through the use of models or other valuation methodologies.

Level 3 - Inputs are unobservable for the asset or liability and include situations where there is little, if any, market activity for the asset or liability. The inputs into the determination of fair value are based upon the best information under the circumstances and may require significant management judgment or estimation.

We consider a two-step process when appraising investments of privately held companies. The first step involves determining the enterprise value of the portfolio company. During this step, we consider three different valuation approaches: a market approach, an income approach, and a cost approach. The particular facts and circumstances of each portfolio company determine which approach, or combination of approaches, will be utilized. The second step when appraising equity investments of privately held companies involves allocating value to the various debt and equity securities of the portfolio company. We allocate value to these securities based on their relative priorities. For equity securities such as warrants, we may also incorporate alternative methodologies including the Black-Scholes Option Pricing Model. Yield analysis is also employed to determine if a debt security has been impaired.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the investment.

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Investments for which prices are not observable are generally private investments in the debt and equity securities of operating companies. The primary valuation method used to estimate the fair value of these Level 3 investments is the discounted cash flow method (although a liquidation analysis, option theoretical, or other methodology may be used when more appropriate). The discounted cash flow approach to determine fair value (or a range of fair values) involves applying an appropriate discount rate(s) to the estimated future cash flows using various relevant factors depending on investment type, including comparing the latest arm's length or market transactions involving the subject security to the selected benchmark credit spread, assumed growth rate (in cash flows), and capitalization rates/multiples (for determining terminal values of underlying portfolio companies). The valuation based on the inputs determined to be the most reasonable and probable is used as the fair value of the investment. The determination of fair value using these methodologies may take into consideration a range of factors including, but not limited to, the price at which the investment was acquired, the nature of the investment, local market conditions, trading values on public exchanges for comparable securities, current and projected operating performance, financing transactions subsequent to the acquisition of the investment and anticipated financing transactions after the valuation date. Application of these valuation methodologies involves a significant degree of judgment by management. Fair values of new investments are generally assumed to be equal to their cost to the Fund for up to twelve months after their initial purchase.

To assess the reasonableness of the discounted cash flow approach, the fair value of equity securities, including warrants, in portfolio companies may also consider the market approach—that is, through analyzing and applying to the underlying portfolio companies, market valuation multiples of publicly-traded firms engaged in businesses similar to those of the portfolio companies. The market approach to determining the fair value of a portfolio company's equity security (or securities) will typically involve: (1) applying, to the portfolio company's trailing twelve months (or current year projected) EBITDA, a low to high range of enterprise value to EBITDA multiples that are derived from an analysis of publicly-traded comparable companies, in order to arrive at a range of enterprise values for the portfolio company; (2) subtracting from the range of calculated enterprise values the outstanding balances of any debt or equity securities that would be senior in right of payment to the equity securities we hold; and (3) multiplying the range of equity values derived therefrom by our ownership share of such equity tranche in order to arrive at a range of fair values for our equity security (or securities). Application of these valuation methodologies involves a significant degree of judgment by our Management.

Due to the inherent uncertainty of determining the fair value of Level 3 investments that do not have a readily available market value, the fair value of the investments may differ significantly from the values that would have been used had a ready market existed for such investments and may differ materially from the values that may ultimately be received or settled. Further, such investments are generally subject to legal and other restrictions or otherwise are less liquid than publicly traded instruments. If we were required to liquidate a portfolio investment in a forced or liquidation sale, we might realize significantly less than the value at which such investment had previously been

recorded. With respect to Level 3 investments, where sufficient market quotations are not readily available or for which no or an insufficient number of indicative prices from pricing services or brokers or dealers have been received, we undertake, on a quarterly basis, a valuation process as described below:

- For each debt investment, a basic credit review process is completed. The risk profile on every credit facility is reviewed and either reaffirmed or revised by our Investment Committee.
- Each portfolio company or investment is valued by an investment professional.

Third party valuation firm(s) are engaged to provide valuation services as requested, by reviewing Management's preliminary valuations and/or analysis of the portfolio investment in question. For investments with a fair value exceeding \$2.5 million held for more than 1 year, our Management's preliminary fair value conclusions on each of the Fund's assets for which sufficient market quotations are not readily available is reviewed and assessed by a third-party valuation firm at least once in every 12-month period, and more often as determined by the Audit Committee or required by our valuation policy. Such valuation assessment may be in the form of positive assurance, range of values or another valuation method based on the discretion of our Board.

- The Audit Committee reviews the preliminary valuations of our Management and independent valuation firms and, if appropriate, recommends the approval of the valuations by the Board.

Our Board discusses valuations and determines the fair value of each investment in the portfolio in good faith based on the input of Management, the Audit Committee and, where appropriate, the respective independent valuation firms.

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The following sections describe the valuation techniques we use to measure different financial instruments at fair value and include the levels within the fair value hierarchy in which the financial instruments are categorized.

**Market approach** - The market approach typically employed by Management calculates the enterprise value of a company as a multiple of earnings before interest, taxes, depreciation and amortization (“EBITDA”) generated by the company for the trailing twelve month period. Adjustments to the company’s EBITDA, including those for non-recurring items, may be considered. Multiples are estimated based on current market conditions and past experience in the private company marketplace and are subjective in nature. We will apply liquidity and other discounts as deemed appropriate to equity valuations where applicable. We 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.

**Income approach** - The income approach typically utilized by our Management calculates the enterprise value of a company utilizing a discounted cash flow model incorporating projected future cash flows of the company. Projected future cash flows consider the historical performance of the company as well as current and projected market participant performance. Discount rates are estimated based on current market conditions and past experience in the private company marketplace and are subjective in nature. We will apply liquidity and other discounts as deemed appropriate to equity valuations where applicable.

**Asset approach** - We consider the asset approach to determine the fair value of significantly deteriorated investments demonstrating circumstances indicative of a liquidation analysis. This situation may arise when a portfolio company: 1) cannot generate adequate cash flow to meet the principal and interest payments on its indebtedness; 2) is not successful in refinancing its debt upon maturity; 3) we believe the credit quality of a loan has deteriorated due to changes in the business and underlying asset or market conditions may result in the company’s inability to meet future obligations; or 4) the portfolio company’s reorganization or bankruptcy. Consideration is also given as to whether a liquidation event would be orderly or forced.

We base 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 will often perform a yield analysis to determine if a debt security has been impaired. Certificates of deposit purchased by the Fund generally will be valued at their face value, plus interest accrued to the date of valuation.

For most of our investments, market quotations are not available. With respect to investments for which market quotations are not readily available or when such market quotations are deemed not to represent fair value, our Board has approved a multi-step valuation process each quarter, as described below:

1. Each portfolio company or investment is reviewed by our investment professionals and, where necessary, with independent valuation firms engaged by the Fund;
2. The independent valuation firms conduct independent valuations and make their own independent assessments;
3. The Audit Committee of our Board reviews and discusses the preliminary valuation of the Fund and that of the independent valuation firms; and
4. The Board discusses valuations and determines the fair value of each investment in our portfolio in good faith based on the input of our Management, the respective independent valuation firm and the Audit Committee.



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Investments are valued utilizing a yield analysis, enterprise value (“EV”) analysis, net asset value analysis, liquidation analysis, discounted cash flow analysis, or a combination of methods, as appropriate. The yield analysis uses loan spreads and other relevant information implied by market data involving identical or comparable assets or liabilities. Under the EV analysis, the EV of a portfolio company is first determined and allocated over the portfolio company’s securities in order of their preference relative to one another (i.e., “waterfall” allocation). To determine the EV, we typically use a market multiples approach that considers relevant and applicable market trading data of guideline public companies, transaction metrics from precedent M&A transactions and/or a discounted cash flow analysis. The net asset value analysis is used to derive a value of an underlying investment (such as real estate property) by dividing a relevant earnings stream by an appropriate capitalization rate. For this purpose, we consider capitalization rates for similar properties as may be obtained from guideline public companies and/or relevant transactions. The liquidation analysis is intended to approximate the net recovery value of an investment based on, among other things, assumptions regarding liquidation proceeds based on a hypothetical liquidation of a portfolio company’s assets. The discounted cash flow analysis uses valuation techniques to convert future cash flows or earnings to a range of fair values from which a single estimate may be derived utilizing an appropriate discount rate. The measurement is based on the net present value indicated by current market expectations about those future amounts.

In applying these methodologies, additional factors that we consider in fair value pricing our investments may include, as we deem relevant: security covenants, call protection provisions, and information rights; the nature and realizable value of any collateral; the portfolio company’s ability to make payments; the principal markets in which the portfolio company does business; publicly available financial ratios of peer companies; the principal market; and enterprise values, among other factors.

Because of the inherent uncertainty of the valuation of portfolio securities which do not have readily ascertainable market values, amounting to \$23.8 million and \$16.2 million as of September 30, 2016 and December 31, 2015, respectively, our fair value determinations may materially differ from the values that would have been used had a ready market existed for these securities. As of September 30, 2016, one of our portfolio investments, 461,292 common shares of MVC, was publicly listed on the NYSE. As of December 31, 2015, one of our portfolio investments, 428,662 common shares of MVC, was publicly listed on the NYSE.

We adjust our net asset value for the changes in the value of our publicly held securities, if applicable, and material changes in the value of private securities, generally determined on a quarterly basis or as announced in a press release, and report those amounts to Lipper Analytical Services, Inc. Our net asset value appears in various publications, including *Barron’s* and *The Wall Street Journal*.

For loan and debt securities held for longer than one year, the Fund will often perform 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.

We will record unrealized depreciation on investments when we determine that the fair value of a security is less than its cost basis, and will record unrealized appreciation when we determine that the fair value is greater than its cost basis.

We assess the levels of the investments at each measurement date, and transfers between levels are recognized on the subsequent measurement date closest in time to the actual date of the event or change in circumstances that caused the transfer. There were no transfers among Level 1, 2 and 3 for the quarter ended September 30, 2016 and the year ended December 31, 2015.

As of September 30, 2016, 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:

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		<b>Fair Value Measurements as of September 30, 2016</b>			
		Quoted	Significant		
		Prices	in Active	Other	Significant
		Markets	Markets	Observable	Unobservable
(in thousands)		Total	for	Inputs	Inputs
		Identical	Identical	(Level 2)	(Level 3)
		Assets	Assets	(Level 2)	(Level 3)
		(Level 1)	(Level 1)	(Level 2)	(Level 3)
Assets					
Investments:					
Control investments		\$5,463	\$—	\$ —	\$ 5,463
Affiliate investments		15,400	—	—	15,400
Non-affiliate investments - related party		3,824	3,824	—	—
Non-affiliate investments		2,978	—	—	2,978
Total investments		27,665	3,824	—	23,841
Temporary cash investments		29,998	29,998	—	—
Total investments and temporary cash investments		\$57,663	\$33,822	\$ —	\$ 23,841

As of December 31, 2015, 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:

		<b>Fair Value Measurements as of December 31, 2015</b>			
		Total	Quoted	Significant	Significant
			Prices	Other	
			in Active	Observable	Unobservable
(in thousands)			Markets	Inputs	Inputs
			for		(Level 3)

**Identical (Level 2)****Assets****(Level 1)**

## Assets

## Investments:

Control investments	\$5,715	\$—	\$ —	\$ 5,715
Affiliate investments	9,600	—	—	9,600
Non-affiliate investments - related party	3,159	3,159	—	—
Non-affiliate investments	915	—	—	915
Total investments	19,389	3,159	—	16,230
Temporary cash investments	15,000	15,000	—	—
Total investments and temporary cash investments	\$34,389	\$18,159	\$ —	\$ 16,230

The following table provides a reconciliation of fair value changes during the nine months ended September 30, 2016 for all investments for which we determine fair value using unobservable (Level 3) factors:

(in thousands)	<b>Fair value measurements using significant unobservable inputs (Level 3)</b>			
	Control Investments	Affiliate Investments	Non-affiliate Investments	Total
Fair value as of December 31, 2015	\$5,715	\$ 9,600	\$ 915	\$16,230
Change in unrealized appreciation (depreciation)	(252 )	5,800	—	5,548
Purchases of portfolio securities	—	—	2,063	2,063
Fair value as of September 30, 2016	\$5,463	\$ 15,400	\$ 2,978	\$23,841

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(Unaudited)

The following table provides a reconciliation of fair value changes during the nine months ended September 30, 2015 for all investments for which we determine fair value using unobservable (Level 3) factors:

(in thousands)	<b>Fair value measurements using significant unobservable inputs (Level 3)</b>			
	Control Investments	Affiliate Investments	Non-affiliate Investments	Total
Fair value as of December 31, 2014	\$13,173	\$ 960	\$ 1,532	\$15,665
Realized gains (losses)	(2,850 )	—	372	(2,478 )
Change in unrealized appreciation (depreciation)	550	6,540	(435 )	6,655
Proceeds from sales/dispositions	(3,158 )	—	(554 )	(3,712 )
Fair value as of September 30, 2015	\$7,715	\$ 7,500	\$ 915	\$16,130

**Foreign Exchange** - We record temporary changes in foreign exchange rates of portfolio securities denominated in foreign currencies as changes in fair value. These changes are therefore reflected as unrealized gains or losses until realized.

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

We classify our investments in accordance with the requirements of the 1940 Act. Under the 1940 Act, "Control Investments" are defined as investments in companies in which the Fund 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 we own 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.

As of September 30, 2016 and December 31, 2015, we had no outstanding commitments to our portfolio company investments; however, under certain circumstances, we may be called on to make follow-on investments in certain portfolio companies. If we do not have sufficient funds to make follow-on investments, the portfolio company in need of the investment may be negatively impacted. Also, our equity interest in the estimated fair value of the portfolio

company could be reduced. Follow-on investments may include capital infusions which are expenditures made directly to, or on behalf of, the portfolio company to ensure that operations are completed, thereby allowing the portfolio company to generate cash flows to service their debt.

**Interest Income Recognition** - We record interest income, adjusted for amortization of premium and accretion of discount, on an accrual basis to the extent that we expect to collect such amounts. We accrete or amortize 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. We stop accruing interest on investments when we determine that interest is no longer collectible. We may also impair the accrued interest when we determine that all or a portion of the current accrual is uncollectible. If we receive any cash after determining that interest is no longer collectible, we treat such cash as payment on the principal balance until the entire principal balance has been repaid, before we recognize any additional interest income. We will write off uncollectible interest upon the occurrence of a definitive event such as a sale, bankruptcy, or reorganization of the relevant portfolio interest.

**Payment in Kind Interest (PIK)** - We have loans in our portfolio that may pay PIK interest. We add 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 our status as a RIC, we must pay out to stockholders this non-cash source of income in the form of dividends even if we have not yet collected any cash in respect of such investments. We 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.

**Cash Flows** - For purposes of the Statements of Cash Flows, we consider all highly liquid temporary cash investments purchased with an original maturity of three months or less to be cash equivalents. We include our investing activities within cash flows from operations. We exclude "Restricted Cash and Temporary Cash Investments" used for purposes of complying with RIC requirements from cash equivalents.

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**Taxes** - We intend 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. We borrow money from time to time to maintain our tax status under the Internal Revenue Code as a RIC. See Note 1 for discussion of Taxable Subsidiaries and see Note 2 for further discussion of the Fund's RIC borrowings.

All corporations organized in the State of Delaware are required to file an Annual Report and to pay a franchise tax. As a result, we paid Delaware Franchise tax in the amount of \$0.01 million and \$0.01 million for the three and nine months ended September 30, 2016, respectively, and \$0.02 million for the year ended December 31, 2015.

Texas margin tax applies to legal entities conducting business in Texas. 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, we have no provision for margin tax expense for the three and nine months ended September 30, 2016, respectively, and we did not owe state income tax for the year ended December 31, 2015.

**Significant Unobservable Inputs** - Our investment portfolio is not composed of homogeneous debt and equity securities that can be valued with a small number of inputs. Instead, the majority of our investment portfolio is composed of complex debt and equity securities with distinct contract terms and conditions. As such, our valuation of each investment in our portfolio is unique and complex, often factoring in numerous different inputs, including historical and forecasted financial and operational performance of the portfolio company, project cash flows, market multiples comparable market transactions, the priority of our securities compared with those of other investors, credit risk, interest rates, independent valuations and reviews and other inputs.

The following table summarizes the significant non-observable inputs in the fair value measurements of our Level 3 investments by category of investment and valuation technique as of September 30, 2016:

(in thousands)	Valuation Techniques	Unobservable Inputs	Range	
			Minimum	Maximum

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	Fair Value					
Secured and subordinated debt	\$2,978	Yield-to-maturity	Discount for lack of marketability EBITDA	0 %	0 %	
Common stock	15,400	Income/Market approach	Multiple/Discount for lack of marketability/Control premium	10 %	32.5 %	
Limited liability company investments	5,463	Asset Approach Discounted cash flow; Guideline transaction method	Recovery rate Reserve adjustment factors	75 %	100 %	
	\$23,841					



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The following table summarizes the significant non-observable inputs in the fair value measurements of our Level 3 investments by category of investment and valuation technique as of December 31, 2015:

<i>(in thousands)</i>	Fair Value	Valuation Techniques	Unobservable Inputs	Range	
				Minimum	Maximum
Secured and subordinated debt	\$915	Yield-to-maturity	Discount for lack of marketability EBITDA	0 %	0 %
Common stock	9,600	Income/Market approach	Multiple/Discount for lack of marketability/Control premium	10 %	32.5 %
Limited liability company investments	5,715	Asset approach	Discounted cash flow; Guideline transaction method	75 %	100 %
	\$16,230				

**(4) Related Party Transactions and Agreements**

Except as noted below, 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. A quarterly fee of \$15,000 is paid to the Chairman of the Audit Committee and a quarterly fee of \$3,750 is paid to the Chairman of the Independent Directors. We may also pay other one-time or recurring fees to members of our Board of Directors in special circumstances. None of our interested directors receive annual fees for their service on the Board of Directors.

In 2011, Equus Energy, LLC, a wholly-owned subsidiary of the Fund, entered into a consulting agreement with Global Energy Associates, LLC (“Global Energy”) to provide consulting services for energy related investments. Henry W. Hankinson, Director, is a managing partner and co-founder of Global Energy. Payments to Global Energy totaled \$56,250 for each of the nine month periods ended September 30, 2016 and 2015.

In respect of services provided to the Fund by members of the Board not in connection with their roles and duties as directors, the Fund pays a fixed amount at a rate of \$250 per hour for services rendered. During the nine months ended September 30, 2016 and 2015, we paid Kenneth I. Denos, P.C., a professional corporation owned by Kenneth I. Denos, a director of the Fund, \$289,313 and \$215,438, respectively, for services provided to the Fund.

#### **(5) Dividends**

We will pay out net investment income and/or realized capital gains, if any, on an annual basis as required under the 1940 Act.

#### **(6) Portfolio Securities**

On January 29, 2016, we invested \$2.0 million in Biogenic Reagents, LLC (“Biogenic”) in the form of a senior secured promissory note originally maturing April 28, 2016 and subsequently extended to June 30, 2016, and bearing cash and PIK interest at the combined rate of 16% per annum. Biogenic is a developer and producer of high value carbon products from renewable biomass, headquartered in Minneapolis. The company has developed and commercialized a low-cost platform technology to make carbon products such as activated carbon for use in purification of air, water, food and pharmaceuticals and agricultural carbon to improve crop production.

On March 2, 2016, we extended the maturity of the 5<sup>TH</sup> Element Tracking, LLC (“5<sup>TH</sup> Element”) promissory note to July 1, 2016 and received fees in the form of a PIK and cash totaling \$0.05 million. Effective June 30, 2016, we agreed to further extend the maturity of the note to October 31, 2016 in exchange for fees in the form of a PIK and cash totaling \$0.05 million. Effective October 31, 2016, in an effort to facilitate refinancing efforts of 5<sup>TH</sup> Element with its senior lender, we further extended the maturity of the note to March 31, 2017.

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2016**

**(Unaudited)**

On April 1, 2016, we received \$40,000 in cash representing payment of accrued cash interest on our \$2.0 million loan to Biogenic, made on January 29, 2016.

During the nine months ended September 30, 2016, we received dividends in the form of additional shares of \$0.2 million relating to our shareholding in MVC.

During the nine months ended September 30, 2016, we recorded an increase of \$5.9 million in net unrealized appreciation, from \$2.4 million to \$8.3 million, in our portfolio securities. Such increase resulted primarily from the following changes:

- (i) Increase in the fair value of our shareholding in MVC of \$0.4 million due to an increase in the MVC share price during the nine months ended September 30, 2016 and the receipt of dividend payments in the form of additional shares of MVC;
- (ii) Increase in the fair value of our shareholding in PalletOne, Inc. of \$5.8 million due to continued strong revenue and earnings growth, and an overall improvement in comparable industry sectors;
- (iii) Decrease in the fair value of our holdings in Equus Energy, LLC of \$0.3 million, principally due to a combination of lower production without a corresponding increase in proved reserves and continued lower short- and long-term prices for crude oil and natural gas.

On January 6, 2015, we sold our interests in Spectrum Management, LLC (“Spectrum”) to 5<sup>th</sup> Element. The purchase price of \$3.9 million paid by 5<sup>th</sup> Element consisted of \$3.0 million in cash and a 1-year subordinated note in the original principal amount of \$0.9 million, bearing interest at the rate of 14% per annum. We realized a net capital loss of \$2.8 million in connection with the sale of our interest in Spectrum.

Also on January 6, 2015, in connection with the sale of our interest in Spectrum, our \$0.5 million loan to Security Monitor Holdings, LLC, together with all accrued interest amounting to approximately \$0.1 million, was repaid.

On January 30, 2015, we received a partial redemption payment in respect of our holding of Notes of Orco Property Group S.A. (“OPG Notes”) in the amount of €36,587 [\$41,478].

On February 20, 2015, we sold our OPG Notes at a discount of 23% to their par value, receiving \$1.0 million in cash and a realized gain of \$0.4 million.

During the nine months ended September 30, 2015, we received dividends in the form of additional shares of \$0.2 million relating to our shareholding in MVC.

During the nine months ended September 30, 2015, we recorded a net change in unrealized appreciation of \$6.0 million, to a net unrealized appreciation of \$2.4 million. Such change in unrealized appreciation resulted primarily from the following changes:

(i) Decrease in the fair value of our holdings in Equus Energy, LLC of \$2.3 million, principally due to a combination of production without a corresponding increase in proved reserves and declining short- and long-term prices for crude oil and natural gas;

(ii) Decrease in the fair value of our shareholding in MVC of \$0.7 million due to a decrease in the MVC share price during the period, which was partially offset by \$0.2 million in dividends received in the form of additional MVC shares;

(iii) Increase in fair value of our shareholding in PalletOne, Inc. of \$6.5 million due to an overall improvement in comparable industry sectors, as well as continued revenue and earnings growth;

(iv) Transfer of unrealized depreciation to realized gain on our holding of OPG Notes of \$0.4 million in connection with the sale of our interest in the OPG Notes; and

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2016**

(Unaudited)

(v) Transfer of unrealized depreciation to realized loss on our holdings in Spectrum of \$2.9 million in connection with the sale of our interest in Spectrum.

**(7) Plan of Reorganization - 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 Management is currently evaluating these alternatives.

**(8) Equus Energy, LLC**

Equus Energy was formed in November 2011 as a wholly-owned subsidiary of the Fund to make investments in companies in the energy sector, with particular emphasis on income-producing oil & gas properties. In December 2011, we contributed \$250,000 to the capital of Equus Energy. On December 27, 2012, we invested an additional \$6.8 million in Equus Energy for the purpose of additional working capital and to fund the purchase of \$6.6 million in working interests, which presently comprise 111 producing and non-producing oil and gas wells. The working interests include associated development rights of approximately 21,200 acres situated on 13 separate properties in Texas and Oklahoma. The working interests range from a *de minimus* amount to 50% of the leasehold that includes these wells.

The wells are operated by a number of experienced operators, including Chevron USA, Inc., which has operating responsibility for all of Equus Energy's 22 producing well interests located in the Conger Field, a productive oil and gas field on the edge of the Permian Basin that has experienced successful gas and hydrocarbon extraction in multiple formations. Equus Energy, which holds a 50% working interest in each of these Conger Field wells, has worked previously with Chevron on a recompletion program of existing Conger Field wells to the Wolfcamp formation, a zone containing oil as well as gas and natural gas liquids. Part of Equus Energy's acreage rights described above also includes a 50% working interest in possible new drilling to the base of the Canyon formation (approximately 8,500 feet) on 2,400 acres in the Conger Field. Also included in the interests acquired by Equus Energy are working interests of 7.5% and 2.5% in the Burnell and North Pettus Units, respectively, which collectively comprise approximately 13,000 acres located in the area known as the "Eagle Ford Shale" play. On October 21, 2016, in exchange for a non-refundable fee of \$62,500, Equus Energy granted a 120-day option to a third-party to acquire all of its mineral interests in approximately 20 acres located in Glasscock County, Texas for an exercise purchase price \$250,000. If exercised, the option fee will be credited toward the purchase price.

*Revenue and Income.* During the three months ended September 30, 2016, Equus Energy's revenue, operating revenue less direct operating expenses, and net loss were \$0.2 million, \$0.1 million, and (\$0.07) million, respectively, as compared to revenue, operating revenue less direct operating expenses, and net income of \$0.2 million, (\$0.05) million, and (\$0.2) million, respectively, for the three months ended September 30, 2015. During the nine months ended September 30, 2016, Equus Energy's revenue, operating revenue less direct operating expenses, and net loss were \$0.4 million, (\$0.07) million, and (\$0.6) million, respectively, as compared to revenue, operating revenue less direct operating expenses, and net loss of \$0.8 million, \$0.02 million, and (\$0.7), respectively, for the nine months ended September 30, 2015.

*Capital Expenditures.* During the nine months ended September 30, 2016, Equus Energy invested \$0.005 million in capital expenditures for small repairs and improvements. The operators of the various working interest have communicated their intent to wait until 2017, commensurate with an anticipated gradual rise in the price of crude oil, to commence new drilling and recompletion projects.

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(Unaudited)

We do not consolidate Equus Energy or its wholly-owned subsidiaries and accordingly only the value of our investment in Equus Energy is included on our statement of assets and liabilities. Our investment in Equus Energy is valued in accordance with our normal valuation procedures and is based in part on using a discounted cash flow analysis based on a reserve report prepared for Equus Energy by Lee Keeling & Associates, Inc., an independent petroleum engineering firm, the transactions and values of comparable companies in this sector, and the estimated value of leasehold mineral interests associated with the acreage held by Equus Energy. A valuation of Equus Energy was performed by a third-party valuation firm, who recommended a value range of Equus Energy consistent with the fair value determined by our Management (See *Schedule of Investments*).

Below is summarized consolidated financial information for Equus Energy as of September 30, 2016 and December 31, 2015 and for the three and nine months ended September 30, 2016 and 2015, respectively, (in thousands):

EQUUS ENERGY, LLCCondensed Consolidated Balance Sheets

	September 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 98	\$ 517
Accounts receivable	49	122
Other current assets	32	32
Total current assets	179	671
Oil and gas properties	8,275	8,269
Less: accumulated depletion, depreciation and amortization	(6,758 )	(6,516 )
Net oil and gas properties	1,517	1,753
Total assets	\$ 1,696	\$ 2,424
Liabilities and member's equity		
Current liabilities:		
Accounts payable and other	\$ 110	\$ 206
Due to affiliate	611	611

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Total current liabilities	721	817
Asset retirement obligations	183	178
Total liabilities	904	995
Total member's equity	792	1,429
Total liabilities and member's equity	\$ 1,696	\$ 2,424

Revenue and direct operating expenses for the various oil and gas assets included in the accompanying statements represent the net collective working and revenue interests acquired by Equus Energy. The revenue and direct operating expenses presented herein relate only to the interests in the producing oil and natural gas properties and do not represent all of the oil and natural gas operations of all of these properties. Direct operating expenses include lease operating expenses and production and other related taxes. General and administrative expenses, depletion, depreciation and amortization (“DD&A”) of oil and gas properties and federal and state taxes have been excluded from direct operating expenses in the accompanying statements of revenues and direct operating expenses because the allocation of certain expenses would be arbitrary and would not be indicative of what such costs would have been had Equus Energy been operated as a stand-alone entity. The statements of revenue and direct operating expenses presented are not indicative of the financial condition or results of operations of Equus Energy on a go forward basis due to changes in the business and the omission of various operating expenses.



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(Unaudited)

EQUUS ENERGY, LLCCondensed Consolidated Statements of Operations

	Three Months ended		Nine Months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Operating revenue	\$248	\$196	\$411	\$788
Operating expenses				
Direct operating expenses	127	242	483	764
Depletion, depreciation, amortization and accretion	110	114	246	462
General and administrative	77	78	319	282
Total operating expenses	314	434	1,048	1,508
Operating loss before income tax expense	(66 )	(238 )	(637 )	(720 )
Net loss	\$(66 )	\$(238 )	\$(637 )	\$(720 )

EQUUS ENERGY, LLCCondensed Consolidated Statements of Cash Flows

	Nine Months ended September 30, 2016 2015	
Cash flows from operating activities:		
Net loss	\$(637)	\$(720)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depletion, depreciation, amortization and accretion	246	462
Changes in operating assets and liabilities:		

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Prepays and deposits	—	22
Accounts receivable and other current assets	73	187
Accounts payable and other	(96 )	1
Net cash used in provided by operating activities	(414)	(48 )
Cash flows from investing activities:		
Investment in oil & gas properties	(5 )	(45 )
Net cash used in investing activities	(5 )	(45 )
Net decrease in cash	(419)	(93 )
Cash and cash equivalents at beginning of period	517	613
Cash and cash equivalents at end of period	\$98	\$520

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2016**

(Unaudited)

**Critical Accounting Policies for Equus Energy** – Equus Energy and its wholly-owned subsidiary EQS Energy Holdings, Inc. (collectively, “the Company”) follow the *Full Cost Method of Accounting* for oil and gas properties. Under the full cost method, all costs associated with property acquisition, exploration, and development activities are capitalized. Capitalized costs include lease acquisitions, geological and geophysical work, delay rentals, costs of drilling, completing and equipping successful and unsuccessful oil and gas wells and related costs. Gains or losses are normally not recognized on the sale or other disposition of oil and gas properties. Gains or losses are normally reflected as an adjustment to the full cost pool.

The capitalized costs of oil and gas properties, plus estimated future development costs relating to proved reserves and estimated cost of dismantlement and abandonment, net of salvage value, are amortized on a unit-of-production method over the estimated productive life of the proved oil and gas reserves. Unevaluated oil and gas properties are excluded from this calculation. Depletion, depreciation, amortization and accretion expense for the Company’s oil and gas properties totaled \$0.1 million for the three months ended September 30, 2016 and September 30, 2015, respectively, and \$0.2 million for the nine months ended September 30, 2016 compared to \$0.5 million for the nine months ended September 30, 2015.

Capitalized oil and gas property costs are limited to an amount (the ceiling limitation) equal to the sum of the following:

- (a) As of September 30, 2016, the present value of estimated future net revenue from the projected production of proved oil and gas reserves, calculated at the simple arithmetic average, first-day-of-the-month prices during the twelve-month period before the balance sheet date (with consideration of price changes only to the extent provided by contractual arrangements) and a discount factor of 10%;
- (b) The cost of investments in unproved and unevaluated properties excluded from the costs being amortized; and
- (c) The lower of cost or estimated fair value of unproved properties included in the costs being amortized.

When it is determined that oil and gas property costs exceed the ceiling limitation, an impairment charge is recorded to reduce its carrying value to the ceiling limitation. The Company did not recognize an impairment loss on its oil and

gas properties during the nine months ended September 30, 2016. However, during 2015, the Company recognized an impairment loss of \$4.0 million.

The costs of certain unevaluated leasehold acreage and certain wells being drilled are not amortized. The Company excludes all costs until proved reserves are found or until it is determined that the costs are impaired. Costs not amortized are periodically assessed for possible impairment or reduction in value. If a reduction in value has occurred, costs being amortized are increased accordingly.

**Revenue Recognition** - Revenue recognized for oil and natural gas sales under the sales method of accounting. Under this method, revenue recognized on production as it is taken and delivered to its purchasers. The volumes sold may be more or less than the volumes entitled to, based on the owner's net leasehold interest. These differences result from production imbalances, which are not significant, and are reflected as adjustments to proven reserves and future cash flows in the unaudited consolidated financial information included herein.

**Accounting Policy on DD&A** - The Company employs the "Units of Production" method in calculating depletion of its proved oil and gas properties, wherein capitalized costs, as adjusted for future development costs and asset retirement obligations, are amortized over the total estimated proved reserves.

**Income Taxes** - A limited liability company is not subject to the payment of federal income taxes as items of income and expenses flow through directly to its members. However, the Company may be liable for certain state income taxes. Texas margin tax applies to legal entities conducting business in Texas, and is assessed on the company's Texas sourced taxable margin. The tax is calculated by applying the appropriate tax rate to a base that considers both revenue and expenses and therefore has the characteristics of an income tax. Taxable Subsidiaries may also generate income tax expense because of the Taxable Subsidiaries' ownership of the portfolio companies; as such we reflect any such income tax expense on our Statements of Operations. As of September 30, 2016 and September 30, 2015, the Company recorded \$0 in federal income taxes.

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**EQUUS TOTAL RETURN, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2016**

**(Unaudited)**

**Asset Retirement Obligations** - The fair value of asset retirement obligations are recorded in the period in which they are incurred if a reasonable estimate of fair value can be made, and the corresponding cost is capitalized as part of the carrying amount of the related long-lived asset. The fair value of the asset retirement obligation is measured using expected future cash outflows discounted at the Company's credit-adjusted risk-free interest rate. Fair value, to the extent possible, should include a market risk premium for unforeseeable circumstances. No market risk premium was included in the Company's asset retirement obligation fair value estimate since a reasonable estimate could not be made. The liability is accreted to its then present value each period, and the capitalized cost is depleted or amortized over the estimated recoverable reserves using the units-of-production method.

**(9) Recent Accounting Pronouncements**

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. Among other things, this ASU requires that public business entities use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. ASU No. 2016-01 is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Our adoption of ASU No. 2016-01 is not anticipated to have a material effect on our financial statements.

**(10) Subsequent Event**

Management performed an evaluation of the Fund's activity through the date the financial statements were issued, noting the following subsequent event:

On October 3, 2016, we sold U.S. Treasury Bills for \$30.0 million and repaid our margin loan.



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**Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

Equus Total Return, Inc. (“we,” “us,” “our,” “Equus,” the “Company,” and the “Fund”), a Delaware corporation, was formed on August 16, 1991. Our shares trade on the New York Stock Exchange under the symbol ‘EQS’. Our investment strategy seeks to provide the highest total return, consisting of capital appreciation and current income.

The information contained in this section should be read in conjunction with our consolidated financial statements and notes thereto appearing elsewhere in this Quarterly Report and in conjunction with the financial statements and notes thereto in the Fund’s Form 10-K for the year ended December 31, 2015, as filed with the SEC. In addition, some of the statements in this report constitute forward-looking statements. The matters discussed in this Quarterly Report, as well as in future oral and written statements by Management of Equus, that are forward-looking statements are based on current Management expectations that involve substantial risks and uncertainties which could cause actual results to differ materially from the results expressed in, or implied by, these forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “proceeds,” “believes,” “estimates,” “predicts,” “potential” or “continue” or the negative of these terms or other similar words. Important assumptions include our ability to originate new investments, achieve certain margins and levels of profitability, and the availability of additional capital. In light of these and other uncertainties, the inclusion of a forward-looking statement in this Quarterly Report should not be regarded as a representation by us that our plans or objectives will be achieved. The forward-looking statements contained in this Quarterly Report include statements as to:

- our future operating results;
- our business prospects and the prospects of our existing and prospective portfolio companies;
- the return or impact of current and future investments;
- our contractual arrangements and other relationships with third parties;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;
- the financial condition and ability of our existing and prospective portfolio companies to achieve their objectives;
- our expected financings and investments;

our regulatory structure and tax treatment;

our ability to qualify and operate as a BDC and a RIC, including the impact of changes in laws or regulations governing our operations, or the operations of our portfolio companies;

the adequacy of our cash resources and working capital;

the timing of cash flows, if any, from the operations of our portfolio companies;

the impact of fluctuations in interest rates on our business;

the valuation of our investments in portfolio companies, particularly those having no liquid trading market;

our ability to recover unrealized losses; and

market conditions and our ability to access additional capital, if deemed necessary.



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There are a number of important risks and uncertainties that could cause our actual results to differ materially from those indicated by such forward-looking statements. For a discussion of factors that could cause our actual results to differ from forward-looking statements contained in this Quarterly Report, please see the discussion in Part II, “Item 1A. Risk Factors”, and in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. You should not place undue reliance on these forward-looking statements. The forward-looking statements made in this Quarterly Report relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances occurring after the date this Quarterly Report is filed with the SEC.

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 subordinate 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 (and 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 is prudent to continue to review alternatives to refine and further clarify the current strategies.

We elected to be treated as a BDC under the 1940 Act. We currently qualify as a RIC for federal income tax purposes and, therefore, are not required to pay corporate income taxes on any income or gains that we distribute to our stockholders. We have certain wholly owned Taxable Subsidiaries each of which holds one or more portfolio investments listed on our Schedules of Investments. The purpose of these Taxable Subsidiaries is to permit us to hold certain income-producing investments or portfolio companies organized as limited liability companies, or LLCs, (or other forms of pass-through entities) and still satisfy the RIC tax requirement that at least 90% of our gross revenue for income tax purposes must consist of investment income. Absent the Taxable Subsidiaries, a portion of the gross income of these income-producing investments or of any LLC (or other pass-through entity) portfolio investment, as the case may be, would flow through directly to us for the 90% test. To the extent that such income did not consist of investment income, it could jeopardize our ability to qualify as a RIC and, therefore, cause us to incur significant federal income taxes. The income of the LLCs (or other pass-through entities) owned by Taxable Subsidiaries is taxed to the Taxable Subsidiaries and does not flow through to us, thereby helping us preserve our RIC status and resultant tax advantages. We do not consolidate the Taxable Subsidiaries for income tax purposes and they may generate income tax expense because of the Taxable Subsidiaries’ ownership of the portfolio investments. We reflect any such income tax expense on our Statements of Operations.

## **Plan of Reorganization**

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 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, and the number of Equus shares sold to MVC represented approximately 16.7% of our issued and outstanding shares of common stock. We incurred dilution of \$0.11 per share as a result of the Share Exchange. Since the announcement, we have received 57,879 shares of MVC (market value of \$0.4 million calculated as of the date of receipt) in the form of dividend payments.

Pursuant to the terms of a Share Exchange Agreement, dated May 14, 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, or a subsidiary of MVC, or one or more of MVC's portfolio companies (the "Consolidation"). Absent Equus merging or consolidating with/into MVC, our current intention is for Equus to (i) consummate the Consolidation, (ii) terminate its election to be classified as a business development company under the 1940 Act, and (iii) be restructured as a publicly-traded operating company focused on the energy and/or financial services sector.

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**Equity Incentive Plan**

On June 13, 2016, the Equus shareholders approved the adoption of the Fund's 2016 Equity Incentive Plan (the "Plan"). The Plan is intended to promote the interests of the Fund by encouraging officers, employees, and directors of the Fund and its affiliates to acquire or increase their equity interest in the Fund and to provide a means whereby they may develop a proprietary interest in the development and financial success of the Fund, to encourage them to remain with and devote their best efforts to the business of the Fund, thereby advancing the interests of the Fund and its stockholders. The Plan is also intended to enhance the ability of the Fund and its affiliates to attract and retain the services of individuals who are essential for the growth and profitability of the Fund. Although certain elements of the Plan require approval from the SEC and may therefore be subsequently modified, the Plan permits the award of restricted stock as well as common stock purchase options. The maximum number of shares of common stock that are subject to awards granted under the Plan is 2,434,728 shares. The term of the Plan will expire on June 13, 2026. No awards have been granted under the Plan and, consequently, no compensation expense has been recorded for the three and nine months ended September 30, 2016.

**Critical Accounting Policies**

See the Fund's Critical Accounting Policies from the disclosure set forth in the Annual Report on Form 10-K for the year ended December 31, 2015.

***Recent Accounting Pronouncements***

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. Among other things, this ASU requires that public business entities use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. ASU No. 2016-01 is effective for public entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Our adoption of ASU No. 2016-01 is not anticipated to have a material effect on our financial statements.

**Current Market Conditions**

Despite relatively low unemployment rates, the U.S. economy expanded at an annualized rate of 2.9% in the third quarter of 2016, following annualized increases of 1.2% and 0.8% for the second and first quarters, respectively, of 2016. The increase was largely attributable to greater consumer spending and higher trade activity, particularly exports. In a survey of 60 economists, the *Wall Street Journal* has predicted GDP growth of 2.2% for 2017 and 2.0%

for 2018, although most economists also forecast a likely recession in the U.S. during the next four fiscal years. (Sources: *U.S. Dept. of Commerce - Bureau of Economic Analysis, Wall Street Journal, CNN Money, Forbes*).

Market conditions for business transactions during 2015, including mergers and acquisitions and private equity investments, improved to their highest level (\$3.8 trillion) since prior to the 2008 financial crisis. Such activity declined in the first nine months of 2016, as a number of high profile transactions were abandoned due to economic and regulatory factors. Nevertheless, corporations have continued a trend of deleveraging and are holding significant amounts of cash and many have focused on acquisitions as part of future growth plans. Overall growth in mergers and acquisitions during the first nine months of 2016 have increased only slightly (0.9%) compared to the same period in 2015. This followed year-over-year growth of 8.2% and 10.8% between 2014-15 and 2013-14, respectively. Private equity funds increased their assets under management during 2015 to a projected \$2.4 trillion, the last period for which data is available, as private equity firms as a group enjoyed more success during the year in attracting investment capital. Results for the first nine months of 2016 are not yet available but are expected to continue this trend. (Sources: *Pitchbook, Bloomberg, Fortune, Forbes*).

During the nine months ended September 30, 2016, our net asset value increased from \$2.94 per share to \$3.27 per share, an increase of 11.2%. As of September 30, 2016, our common stock is trading at a 43.2% discount to our net asset value as compared to 39.2% as of December 31, 2015.

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Over the past several years, we have executed certain initiatives to enhance liquidity, achieve a lower operational cost structure, provide more assistance to portfolio companies and realize certain of our portfolio investments. Specifically, we changed the composition of our Board of Directors and Management, terminated certain of our follow-on investments, internalized the management of the Fund, suspended our managed distribution policy, modified our investment strategy to pursue shorter-term liquidation opportunities, pursued non-cash investment opportunities, and sold certain of our legacy and underperforming investment holdings. We believe these actions continue to be necessary to protect capital and liquidity in order to preserve and enhance shareholder value. Because our Management is internalized, certain of our expenses should not increase commensurate with an increase in the size of the Fund and, therefore, we expect to achieve efficiencies in our cost structure if we are able to grow the Fund.

## **Liquidity and Capital Resources**

We generate cash primarily from maturities, sales of securities and borrowings, as well as capital gains realized upon the sale of portfolio investments. We use 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 our stockholders.

Because of the nature and size of the portfolio investments, we may periodically borrow funds to make qualifying investments to maintain our tax status as a RIC. We often borrow such funds 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 its net investment income and realized capital gains, and distributions to stockholders would be subject to income tax as ordinary dividends.

The Fund has the ability to borrow funds and issue forms of senior securities representing indebtedness or stock, such as preferred stock, subject to certain restrictions. Net taxable investment income and net taxable realized gains from the sales of portfolio investments are intended to be distributed at least annually, to the extent such amounts are not reserved for payment of expenses and contingencies or to make follow-on or new investments.

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 stockholders will be able to claim their proportionate share of the federal income taxes paid 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.

We are evaluating the impact of current market conditions on our portfolio company valuations and their ability to provide current income. We have followed valuation techniques in a consistent manner; however, we are cognizant of current market conditions that might affect future valuations of portfolio securities. We believe that our 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.

## **Results of Operations**

### **Investment Income and Expense**

Net investment loss was \$0.6 million and \$0.4 million for the three months ended September 30, 2016 and 2015, respectively, and \$1.8 million and \$2.0 million for the nine months ended September 30, 2016 and September 30, 2015, respectively. The decrease in net investment loss generated at September 30, 2016 compared to September 30, 2015 is due primarily to an increase in total investment income.

Investment income was \$0.2 million and \$0.09 million for the three months ended September 30, 2016 and September 30, 2015, respectively, and \$0.6 million and \$0.2 million for the nine months ended September 30, 2016 and September 30, 2015, respectively. The increase in investment income was primarily due to the increase in income producing investments, including interest income from our loan to Biogenic Reagents, LLC and the MVC share dividends received during the three and nine months ended September 30, 2016.

Total expenses were \$0.8 million and \$0.5 million for the three months ended September 30, 2016 and September 30, 2015, respectively, and unchanged at \$2.3 million for the nine months ended September 30, 2016 and September 30, 2015. The increase is principally due to professional fees paid during the three months ended September 30, 2016.

Table of Contents**Realized Gains and Losses on Sales of Portfolio Securities**

During the nine months ended September 30, 2016, we realized a loss of \$9.0 thousand from the sale of temporary cash investments.

During the nine months ended September 30, 2015, we realized net capital losses of \$2.5 million, including the following significant transactions (in thousands):

<b>Portfolio Company</b>	<b>Industry</b>	<b>Type</b>	<b>Transaction Type</b>	<b>Realized Gain (Loss)</b>
Spectrum Management, LLC	Business products and services	Control	Disposition	\$(2,850)
Orco Property Group S. A.	Real Estate	Non-affiliate	Disposition	372
Various others			Disposition	(5 )
				\$(2,483)

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

During the nine months ended September 30, 2016, we recorded an increase of \$5.9 million in net unrealized appreciation, from \$2.4 million to \$8.3 million, in our portfolio securities. Such increase resulted primarily from the following changes:

- (i) Increase in the fair value of our shareholding in MVC of \$0.4 million due to an increase in the MVC share price during the nine months ended September 30, 2016 and the receipt of dividend payments in the form of additional shares of MVC;
- (ii) Increase in the fair value of our shareholding in PalletOne, Inc. of \$5.8 million due to continued strong revenue and earnings growth, and an overall improvement in comparable industry sectors;
- (iii) Decrease in the fair value of our holdings in Equus Energy, LLC of \$0.3 million, principally due to a combination of lower production without a corresponding increase in proved reserves and continued lower short- and long-term prices for crude oil and natural gas.

During the nine months ended September 30, 2015, we recorded a net change in unrealized appreciation of \$6.0 million, to a net unrealized appreciation of \$2.4 million. Such change in unrealized appreciation resulted primarily from the following changes:

(i) Decrease in the fair value of our holdings in Equus Energy, LLC of \$2.3 million, principally due to a combination of production without a corresponding increase in proved reserves and declining short- and long-term prices for crude oil and natural gas;

(ii) Decrease in the fair value of our shareholding in MVC of \$0.7 million due to a decrease in the MVC share price during the period, which was partially offset by \$0.2 million in dividends received in the form of additional MVC shares;

(iii) Increase in the fair value of our shareholding in PalletOne, Inc. of \$6.5 million due to an overall improvement in the industry sector for packaging companies, as well as continued revenue and earnings growth;

(iv) Transfer of unrealized depreciation to realized gain on our holding of OPG Notes of \$0.4 million in connection with the sale of our interest in the OPG Notes; and

(v) Transfer of unrealized depreciation to realized loss on our holdings in Spectrum of \$2.9 million in connection with the sale of our interest in Spectrum.

## **Dividends**

We will 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.



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**Portfolio Securities**

On January 29, 2016, we invested \$2.0 million in Biogenic Reagents, LLC (“Biogenic”) in the form of a senior secured promissory note originally maturing April 28, 2016 and subsequently extended to June 30, 2016, and bearing cash and PIK interest at the combined rate of 16% per annum. Biogenic is a developer and producer of high value carbon products from renewable biomass, headquartered in Minneapolis. The company has developed and commercialized a low-cost platform technology to make carbon products such as activated carbon for use in purification of air, water, food and pharmaceuticals and agricultural carbon to improve crop production.

On March 2, 2016, we extended the maturity of the 5<sup>TH</sup> Element Tracking, LLC (“5<sup>TH</sup> Element”) promissory note to July 1, 2016 and received fees in the form of a PIK and cash totaling \$0.05 million. Effective June 30, 2016, we agreed to further extend the maturity of the note to October 31, 2016 in exchange for fees in the form of a PIK and cash totaling \$0.05 million. Effective October 31, 2016, in an effort to facilitate refinancing efforts of 5<sup>TH</sup> Element with its senior lender, we further extended the maturity of the note to March 31, 2017.

On April 1, 2016, we received \$40,000 in cash representing payment of accrued cash interest on our \$2.0 million loan to Biogenic, made on January 29, 2016.

On July 4, 2016, we issued a notice of default to Biogenic Reagents, LLC (“Biogenic”), regarding a senior secured promissory note issued by Biogenic to the Fund in the principal amount of \$2.0 million. Based on our evaluation of the liquidation value of the assets of Biogenic and the seniority of our claim, we believe Equus will recover the principal amount and all interest as accrued in connection with this note.

On October 21, 2016, in exchange for a non-refundable fee of \$62,500, Equus Energy granted a 120-day option to a third-party to acquire all of Equus Energy’s mineral interests in approximately 20 acres located in Glasscock County, Texas, for an exercise purchase price of \$250,000. We believe that the receipt of the option fee, the anticipated receipt of the exercise purchase price for the option, and overall improved operational performance of Equus Energy will enable Equus Energy to maintain sufficient liquidity to meet its obligations for the next 12 months.

During the nine months ended September 30, 2016, we received dividends in the form of additional shares of \$0.2 million relating to our shareholding in MVC.

On January 6, 2015, we sold our interests in Spectrum to 5<sup>th</sup> Element. The purchase price of \$3.9 million paid by 5<sup>th</sup> Element consisted of \$3.0 million in cash and a 1-year subordinated note in the original principal amount of \$0.9

million, bearing interest at the rate of 14% per annum. We realized a net capital loss of \$2.8 million in connection with the sale of our interest in Spectrum.

Also on January 6, 2015, in connection with the sale of our interest in Spectrum, our \$0.5 million loan to Security Monitor Holdings, LLC, together with all accrued interest amounting to approximately \$0.1 million, was repaid.

On January 30, 2015, we received a partial redemption payment in respect of our holding of OPG Note in the amount of €36,587 [\$41,478].

On February 20, 2015, we sold our OPG Notes at a discount of 23% to their par value, receiving \$1.0 million in cash and a realized gain of \$0.4 million.

During the nine months ended September 30, 2015, we received dividends in the form of additional shares of \$0.2 million relating to our shareholding in MVC.

### **Subsequent Events**

Management performed an evaluation of the Fund's activity through the date the financial statements were issued, noting the following subsequent events:

On October 3, 2016, we sold U.S. Treasury Bills for \$30.0 million and repaid our margin loan.

On October 21, 2016, in exchange for a non-refundable fee of \$62,500, Equus Energy granted a 120-day option to a third-party to acquire all of its mineral interests in approximately 20 acres located in Glasscock County, Texas for an exercise purchase price of \$250,000. If exercised, the option fee will be credited toward the purchase price.

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**Item 3. Quantitative and Qualitative Disclosure about Market Risk**

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

Our 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. We determine their fair values based on the terms of the relevant debt security and the financial condition of the issuer.

A major portion of our 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 could also consist of common stock 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.

We are 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 user. The value of one segment called “Shipping products and services” includes one portfolio company, PalletOne, Inc., and was 37.1% of the net asset value and 55.7% of our investments in portfolio company securities (at fair value) as of September 30, 2016. 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 our common stock to a greater extent than would be the case if we were a “diversified” company holding numerous investments.

**Item 4. Controls and Procedures**

The Fund maintains disclosure controls and other procedures that are designed to ensure that information required to be disclosed by the Fund in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is

accumulated and communicated to the Fund's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

The Fund's management, with the participation of the Fund's Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the design and operations of the Fund's "disclosure controls and procedures" (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of September 30, 2016. Based on their evaluation, the Fund's Chief Executive Officer and Chief Financial Officer concluded that the Fund's disclosure controls and procedures were effective at a reasonable assurance level. There has been no change in the Fund's internal control over financial reporting during the quarter ended September 30, 2016, that has materially affected, or is reasonably likely to materially affect, the Fund's internal control over financial reporting.

## **Part II. Other Information**

### **Item 1. Legal Proceedings**

From time to time, the Fund is also a party to certain proceedings incidental to the normal course of our business including the enforcement of our rights under contracts with our portfolio companies. While the outcome of these legal proceedings cannot at this time be predicted with certainty, we do not expect that these proceedings will have a material effect upon the Fund's financial condition or results of operations.

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**Item 1A. Risk Factors**

There have been no material changes in the Fund's risk factors from the disclosure set forth in the Annual Report on Form 10-K for the year ended December 31, 2015.

Readers should carefully consider these risks and all other information contained in the annual report on Form 10-K, including the Fund's 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.

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**Item 6. 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]  
Certificate of Merger dated June 30, 1993, between the Fund and Equus Investments Incorporated
- (b) [Incorporated by reference to Exhibit 3(c) 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(b) to Registrant's Current Report on Form 8-K filed on June 30, 2014.]

10. Material Contracts.

- (a) Safekeeping Agreement between the Fund and Amegy Bank dated August 16, 2008. [Incorporated by reference to Exhibit 10(c) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2008.]
- (b) Form of Indemnification Agreement between the Fund and its directors and certain officers. [Incorporated by reference to Exhibit 10(d) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2011.]
- (c) 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.]
- (d) Code of Ethics of the Fund (Rule 17j-1) [Incorporated by reference to Exhibit 10(f) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2009.]
- (e) Share Exchange Agreement between the Fund and MVC Capital, Inc., dated May 14, 2014. [Incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K, filed on May 15, 2014.]
- (f) 2016 Equity Incentive Plan of the Fund. [Incorporated by reference to Exhibit 1 to Registrant's Definitive Proxy Statement filed on May 5, 2016]

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

- 1. Certification by Chief Executive Officer
- 2. Certification by Chief Financial Officer

32. Section 1350 Certifications

- 1. Certification by Chief Executive Officer
- 2. Certification by Chief Financial Officer

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SIGNATURE

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.

Date: November 10, 2016

EQUUS TOTAL RETURN, INC.

/s/ John A. Hardy

**John A. Hardy**

**Chief Executive Officer**