

EQUUS TOTAL RETURN, INC.

Form 10-Q

May 15, 2008

Table of Contents

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 March 31, 2008

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 0-19509

EQUUS TOTAL RETURN, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

77019
(Zip Code)

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

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 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 8,496,202 shares of the registrant's common stock, \$.001 par value, outstanding, as of May 15, 2008. The net asset value of a share at March 31, 2008 was \$ 12.20.

Table of Contents

EQUUS TOTAL RETURN, INC.

(A Delaware Corporation)

INDEX

	PAGE
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
<u>Balance Sheets March 31, 2008 and December 31, 2007</u>	3
<u>Statements of Operations For the three months ended March 31, 2008 and 2007</u>	4
<u>Statements of Changes in Net Assets For the three months ended March 31, 2008 and 2007</u>	5
<u>Statements of Cash Flows For the three months ended March 31, 2008 and 2007</u>	6
<u>Selected Per Share Data and Ratios For the three months ended March 31, 2008 and 2007</u>	7
<u>Schedule of Portfolio Securities March 31, 2008</u>	8
<u>Notes to Financial Statements</u>	12
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
<u>Item 3. Quantitative and Qualitative Disclosure about Market Risk</u>	25
<u>Item 4. Controls and Procedures</u>	25
PART II. OTHER INFORMATION	
<u>Item 6. Exhibits</u>	25
<u>SIGNATURE</u>	26

Table of ContentsEQUUS TOTAL RETURN, INC.BALANCE SHEETS

(in thousands, except per share amounts)	March 31, 2008 (unaudited)	December 31, 2007
Assets		
Investments in portfolio securities at fair value:		
Control investments (cost at \$29,062 and \$27,610, respectively)	\$ 31,771	29,812
Affiliate investments (cost at \$18,050 and \$14,721, respectively)	35,440	32,111
Non-affiliate investments (cost at \$16,126 and \$12,952, respectively)	13,145	\$ 10,179
Total investments in portfolio securities at fair value	80,356	72,102
Restricted cash & temporary investments, at cost which approximates fair value	35,349	30,296
Cash		28
Temporary cash investments, at cost which approximates fair value	22,846	30,912
Accounts receivable	8	107
Accrued interest and dividends receivable due from portfolio companies	1,377	1,023
Escrowed receivables, at fair value	262	262
Total assets	\$ 140,198	\$ 134,730
Liabilities and net assets		
Liabilities:		
Bank overdraft	\$ 262	\$
Accounts payable and accrued liabilities	110	108
Due to adviser	1,166	1,410
Borrowing under margin account	34,999	29,996
Total liabilities	36,537	31,514
Commitments and contingencies		
Net assets:		
Preferred stock, \$.001 par value, 5,000 shares authorized, no shares outstanding		8
Common stock, \$.001 par value, 50,000 shares authorized, 8,496 and 8,401 shares outstanding, respectively	8	8
Additional paid-in capital	89,658	89,021
Undistributed net investment losses	(3,548)	(3,772)
Undistributed net capital gains	425	1,141
Net unrealized appreciation of portfolio securities	17,118	16,818
Total net assets	\$ 103,661	\$ 103,216
Net assets per share	\$ 12.20	\$ 12.29

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

Table of ContentsEQUUS TOTAL RETURN, INC.STATEMENTS OF OPERATIONSFOR THE THREE MONTHS ENDED MARCH 31, 2008 AND 2007

(Unaudited)

(in thousands, except per share amounts)	2008	2007
Investment income:		
Interest and dividend income from portfolio securities:		
Control investments	\$ 395	\$ 422
Affiliate investments	247	73
Non-affiliate investments	441	183
Total interest and dividend income	1,083	678
Interest from temporary cash investments	251	533
Total investment income	1,334	1,211
Expenses:		
Management fee	502	460
Incentive fee	17	263
Professional fees	173	160
Administrative fees	113	113
Director fees and expenses	90	88
Mailing, printing and other expenses	24	100
Interest expense	6	22
Total expenses	925	1,206
Net investment income	409	5
Net realized gain on portfolio securities		
Control investments	74	1,472
Affiliate investments	351	124
Non-affiliate investments		
Total net realized gain on portfolio securities	425	1,596
Net unrealized appreciation of portfolio securities:		
End of period	17,118	7,119
Beginning of period	16,818	9,292
Net change in unrealized appreciation of portfolio securities	300	(2,173)
Net increase (decrease) in net assets resulting from operations	\$ 1,134	\$ (572)
Net increase (decrease) in net assets resulting from operations per share:		
Basic and diluted	\$ 0.13	\$ (0.07)
Weighted average shares outstanding, in thousands		

Basic and diluted

8,402

8,165

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

Table of ContentsEQUUS TOTAL RETURN, INC.STATEMENTS OF CHANGES IN NET ASSETSFOR THE THREE MONTHS ENDED MARCH 31, 2008 AND 2007

(Unaudited)

(in thousands)	2008	2007
Operations:		
Net investment income	\$ 409	\$ 5
Net realized gain on portfolio securities	425	1,596
Net change in unrealized appreciation of portfolio securities	300	(2,173)
Net increase (decrease) in net assets resulting from operations	1,134	(572)
Capital share transactions:		
Dividends declared	(1,327)	(1,021)
Shares issued in dividend	638	455
Decrease in net assets from capital share transactions	(689)	(566)
Increase (decrease) in net assets	445	(1,138)
Net assets at beginning of period	103,216	93,236
Net assets at end of period	\$ 103,661	\$ 92,098

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

Table of ContentsEQUUS TOTAL RETURN, INC.STATEMENTS OF CASH FLOWSFOR THE THREE MONTHS ENDED MARCH 31, 2008 AND 2007

(Unaudited)

(in thousands)	2008	2007
Reconciliation of increase (decrease) in net assets from operations to net cash provided by (used in) operating activities:		
Net increase (decrease) in net assets resulting from operations	\$ 1,134	\$ (572)
Adjustments to reconcile increase (decrease) in net assets resulting from operations to net cash provided by (used in) operating activities:		
Net realized gain on portfolio securities	(425)	(1,596)
Net change in unrealized appreciation of portfolio securities	(300)	2,173
Increase in accrued interest and dividends receivable due from portfolio companies	(354)	(166)
Increase in escrowed receivables		(1,308)
Decrease in accounts receivable and other	99	130
Accrued interest or dividends exchanged for portfolio securities	(221)	(112)
Increase (decrease) in accounts payable and accrued liabilities	2	(49)
Decrease in due to adviser	(244)	(1,500)
Purchase of portfolio securities	(10,600)	(7,619)
Proceeds from dispositions of portfolio securities	3,292	1,596
Principal payments from portfolio securities		1,697
(Purchases) sales of restricted temporary cash investments	(5,053)	3
Net cash used in operating activities	\$ (12,670)	\$ (7,323)
Cash flows from financing activities:		
Bank overdraft	262	98
Borrowings under margin account	34,999	29,976
Repayments under margin account	(29,996)	(29,979)
Dividends paid	(689)	(566)
Cash paid for deferred costs		(93)
Net cash provided by (used in) financing activities	4,576	(564)
Net decrease in cash and cash equivalents	(8,094)	(7,887)
Cash and cash equivalents at beginning of period	30,940	51,499
Cash and cash equivalents at end of period	\$ 22,846	\$ 43,612
Non-cash financing activities:		
Shares issued in lieu of cash dividend	\$ 638	\$ 455
Supplemental disclosure of cash flow information		
Interest paid	\$ 11	\$ 30

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

Table of ContentsEQUUS TOTAL RETURN, INC.SUPPLEMENTAL INFORMATION - SELECTED PER SHARE DATA AND RATIOSFOR THE THREE MONTHS ENDED MARCH 31, 2008 AND 2007

(Unaudited)

	2008	2007
Investment income	\$ 0.16	\$ 0.15
Expenses	0.11	0.15
Net investment income	0.05	0.00
Net realized gain on portfolio securities	0.05	0.20
Net change in unrealized appreciation of portfolio securities	0.04	(0.27)
Increase (decrease) in net assets resulting from operations	0.14	(0.07)
Capital Transactions:		
Dividend declared	(0.16)	(0.13)
Dilutive effect of shares issued in common stock dividend and exercise of options	(0.07)	(0.01)
Decrease in net assets from capital transactions	(0.23)	(0.14)
Net decrease in net assets	(0.09)	(0.21)
Net assets at beginning of period	12.29	11.42
Net assets at end of period	\$ 12.20	\$ 11.21
Weighted average number of shares outstanding during period, in thousands	8,402	8,165
Market value per share at end of period	\$ 6.75	\$ 8.75
Ratio of expenses to average net assets	0.89%	1.30%
Ratio of net investment income (loss) to average net assets	0.40%	(0.01)%
Ratio of increase (decrease) in net assets resulting from operations to average net assets	1.10%	(0.62)%
Total return on market price	9.48% *	3.92%

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

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

Table of Contents

EQUUS TOTAL RETURN, INC.
SCHEDULE OF PORTFOLIO SECURITIES

March 31, 2008

Name and Location of Portfolio Company	Industry	Date of Initial Investment	Investment	Principal	Cost of Investment	Fair Value (3)
				<i>(amounts in thousands)</i>		
Control investments: Majority-owned (7):						
Creekstone Florida Holdings, LLC	Real estate	December 2005(4)	17-19.8% subordinated promissory note(1)	\$4,000	\$ 4,154	\$ 4,154
Houston, TX						
Equus Media Development Company, LLC	Media	January 2007(4)	Member Interest		5,000	5,000
Houston, TX						
Riptide Entertainment, LLC	Entertainment and leisure	December 2005(4)	Member interest (64.67%)		65	65
Miami, FL						
			8% promissory notes	6,435	6,435	6,435
Spectrum Management, LLC	Business products and services	December 1999	285,000 units of Class A equity interest		2,850	6,663
Carrollton, TX						
			16% subordinated promissory note(1)(2)	1,304	1,304	1,304
			12.75% subordinated promissory note(2)	386	386	386
Total Control investments: Majority-owned (represents 29.9% of total investments at fair value)					\$20,194	\$24,007
Control Investments: Non-majority-owned (6):						
ConGlobal Industries Holding, Inc.	Shipping products and services	February 1997	24,397,303 shares of common stock		\$ 1,370	\$
Houston, TX						
			Promissory note(2)	\$3,266	\$ 3,266	3,367
			Member interest in CCI-ANI Finance, LLC(2)		2,734	2,819
			Member interest (66.7%) in JL Madre, LLC(1)		864	892
			Member interest (28.3%) in JL Madre(1) Equipment, LLC		69	121
HealthSPAC, LLC	Healthcare	December 2006(4)	Member interest (40%)		565	565
El Segundo, CA						
Total Control Investments: Non-majority-owned (represents 9.6% of total investments at fair value)					\$ 8,868	\$ 7,764
Total Control Investments: (represents 39.5% of total investments at fair value)					\$29,062	\$31,771

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

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

(Unaudited)

(Continued)

Name and Location of

Portfolio Company	Industry	Date of Initial Investment	Investment	Principal	Cost of Investment	Fair Value (3)
Affiliate Investments (5):						
Infinia Corporation	Alternative energy	June 2007(4)	666,667 Class A Shares Preferred Stock		\$ 3,000	\$20,740
Kennewick, WA			160,720 Class B Shares Preferred Stock		5,000	5,000
Nickent Golf, Inc.	Entertainment and leisure	June 2007(4)	13% Promissory Note	\$6,127	6,127	6,127
City of Industry, CA			3,000,000 shares Class A Convertible Preferred Stock Warrants to buy 463,917 shares of common stock at \$0.97 per share through August 4, 2009, warrant terms subject to change		3,000	3,000
PalletOne, Inc.	Shipping products and services	October 2001	350,000 shares of common stock		350	
South Bartow, FL						
RP&C International Investments LLC	Healthcare	September 2006(4)	Membership Interest (17.2%)		573	573
New York, NY						
Total Affiliate Investments (represents 44.1% of total investments at fair value)					\$18,050	\$35,440

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

Table of ContentsEQUUS TOTAL RETURN, INC.SCHEDULE OF PORTFOLIO SECURITIESMARCH 31, 2008

(Unaudited)

(Continued)

Name and Location of

Portfolio Company	Industry	Date of Initial Investment	Investment	Principal	Cost of Investment	Fair Value (3)
Non-Affiliate Investments (less than 5% owned):						
1848 Capital Partners LLC New York, NY	Entertainment and leisure	January 2008(4)	Promissory note(1)	\$3,000	\$ 3,000	\$ 3,000
Big Apple Entertainment New York, NY	Entertainment and leisure	October 2007(4)	Promissory note(1)	3,000	3,000	3,000
The Bradshaw Group Richardson, TX	Business products and services	May 2000	576,828 Class B Shares 12.25% preferred stock 38,750 Class C shares preferred stock 788,649 Class D shares 15% preferred stock 2,218,109 Class E shares 8% preferred stock Warrant to buy 2,229,450 shares of common stock through May 2008		1,795	277
Sovereign Business Forms, Inc. Houston, TX	Business products and services	August 1996	29,854 shares of preferred stock(1)(2) 15% promissory notes(1)(2) Warrant to buy 551,894 shares of common stock at \$1 per share through Aug 2008 Warrant to buy 25,070 shares of common stock at \$1.25 per share through Aug 2008 Warrant to buy 273,450 shares of common stock at \$1 per share through Oct 2009		3,053	1,590
Total Non-Affiliate Investments (represents 16.4% of total investments at fair value)					\$16,126	\$13,145
Total Investments					\$63,238	\$80,356

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

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

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- (3) See Business Valuation.
- (4) Investments subsequent to June 30, 2005 were selected, and are managed, by the Adviser.
- (5) Affiliate investments are generally defined under the Investment Company Act of 1940 as companies in which the Fund owns at least 5% but not more than 25% voting securities of the company.
- (6) Non-majority owned control investments are generally defined under the Investment Company Act of 1940 as companies in which the Fund owns more than 25% but not more than 50% of the voting securities of the company.
- (7) Majority owned investments are generally defined under the Investment Company Act of 1940 as companies in which the Fund owns more than 50% of the voting securities of the company.

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

Table of ContentsEQUUS TOTAL RETURN, INC.SCHEDULE OF PORTFOLIO SECURITIESMARCH 31, 2008

(Unaudited)

(Continued)

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

As defined in the Investment Company Act of 1940, all of the Fund's investments are in eligible portfolio companies. The Fund provides significant managerial assistance to all of the portfolio companies in which it has invested. The Fund provides significant managerial assistance to portfolio companies that comprise 93% of the total value of the investments in portfolio companies as of March 31, 2008.

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

Type of Securities	Cost	Fair Value	Fair Value as Percentage of Net Assets
Secured and subordinated debt	\$ 32,950	\$ 33,051	31.9%
Preferred stock	15,847	30,606	29.5%
Limited liability company	12,720	16,699	16.1%
Common stock	1,721		0.0%
Options and warrants			0.0%
Total	\$ 63,238	\$ 80,356	77.5%

Two notes receivable included in secured and subordinated debt with an estimated fair value of \$7.7 million provide that all or a portion of interest is paid in kind or that the original issue discount is accreted over the life of the notes, by adding such amount to the principal of the notes. In addition, cash payments of interest are currently being received on notes aggregating \$25.3 million in fair value.

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

Industry	Fair Value	Fair Value as Percentage of Net Assets
Alternative energy	\$ 25,740	24.8%
Entertainment and leisure	21,627	20.9%
Business products and services	15,497	14.9%
Shipping products and services	7,200	6.9%
Media	5,000	4.8%
Real estate	4,154	4.0%
Healthcare	1,138	1.1%

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Total

\$ 80,356

77.5%

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

Table of Contents

EQUUS TOTAL RETURN, INC.

NOTES TO FINANCIAL STATEMENTS

March 31, 2008 AND 2007

(Unaudited)

(1) **Organization and Business Purpose**

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

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

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

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

(2) **Liquidity and Financing Arrangements**

Liquidity and Revolving Line of Credit As of March 31, 2008, the Fund had cash and temporary cash investments of \$22.8 million. The Fund had \$80.4 million of its total assets of \$140.2 million invested in portfolio securities. Restricted assets totaled \$35.3 million, of which \$35.0 million was invested in U.S. Treasury Bills for the purpose of satisfying the diversification requirement to maintain the Fund's pass-through tax treatment and \$0.3 million represented a required 1% brokerage margin deposit. These securities are held by a securities brokerage firm and are pledged along with cash to secure the payment of the margin account balance. The U.S. Treasury bills were sold and the margin loan was repaid to the brokerage firm on April 2, 2008.

Table of Contents

On February 19, 2008, the Fund revised its managed distribution policy to pay 10% of the Fund's market value based on the 2007 year-end closing price of \$6.31 and announced the declaration of a first quarter dividend of \$0.158 per share accordingly. A dividend in the amount of \$1.3 million was paid on March 31, 2008 to shareholders of record as of February 29, 2008. The dividend was payable in shares of common stock or in cash by specific election of the shareholders, and such election was made by March 24, 2008. The fund paid \$ 0.7 million in cash, and issued 95,023 additional shares of its common stock at an effective price of \$6.71 per share. The classification of this dividend as between ordinary income, capital gain and return of capital will not be known until December 31, 2008, since any purchase or sale of a portfolio company during the remainder of the year will affect the classification.

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

RIC Borrowings, Restricted Cash and Temporary Investments During the three months ended March 31, 2008 and March 31, 2007, the Fund borrowed sufficient funds to maintain the Fund's RIC status by utilizing a margin account with a securities brokerage firm. There is no assurance that such arrangement will be available in the future. If the Fund is unable to borrow funds to make qualifying investments, it may no longer qualify as a RIC. The Fund would then be subject to corporate income tax on the Fund's net investment income and realized capital gains, and distributions to stockholders would be subject to income tax as ordinary dividends. Failure to continue to qualify as a RIC could be material to us and the Fund's stockholders.

As of March 31, 2008, the Fund borrowed \$35.0 million to make qualifying investments to maintain its RIC status by utilizing a margin account with a securities brokerage firm. The Fund collateralized such borrowings with restricted cash and temporary investments in U.S. Treasury bills of \$35.3 million. The U.S. Treasury bills were sold and the total amount borrowed was repaid on April 2, 2008.

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

(3) **Significant Accounting Policies**

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

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

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

Publicly-traded portfolio securities Investments in companies whose securities are publicly traded are valued at their quoted market price at the close of business on the valuation date, less a discount to reflect the estimated effects of restrictions on the sale of such securities (Valuation Discount), if applicable.

Table of Contents

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

Generally, cost is the primary factor used to determine fair value until significant developments affecting the portfolio company (such as results of operations or changes in general market conditions) provide a basis for use of an appraisal valuation. Thereafter, portfolio investments are carried at appraised values as determined quarterly by the Adviser, subject to the approval of the Board of Directors. Appraisal valuations are based upon such factors as a portfolio company's earnings, cash flow and net worth, the market prices for similar securities of comparable companies, an assessment of the company's current and future financial prospects and various other factors and assumptions. In the case of unsuccessful operations, the appraisal may be based upon liquidation value.

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

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

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

The fair values of debt securities, which are generally held to maturity, are determined on the basis of the terms of the debt securities and the financial condition of the issuer. Certificates of deposit purchased by the Fund generally will be valued at their face value, plus interest accrued to the date of valuation.

Because of the inherent uncertainty of the valuation of portfolio securities, which do not have readily ascertainable market values, amounting to \$80.4 million (including no publicly traded securities) and \$72.1 million (including no publicly traded securities) as of March 31, 2008 and December 31, 2007, respectively, the Fund's estimate of fair value may materially differ from the value that would have been used had a ready market existed for the securities. Appraised values do not reflect brokers' fees or other normal selling costs which might become payable on disposition of such investments.

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

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

Escrowed Receivables, at Estimated Fair Value In May of 2007, the Fund sold its interest in The Drilltec Corporation (Drilltec). A portion of the proceeds from the sale was placed in a cash escrow account to secure the representations and warranties made to the respective purchasers. As of March 31, 2008, the amount receivable from the Drilltec escrow is valued at \$0.3 million. The Fund is not aware of any claims against the escrow that have been made as of March 31, 2008 and is anticipating a final payment from The Drilltec Corporation escrow account by May 2008.

Table of Contents

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

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

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

(4) **Fair Value Measurement**

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

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

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

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

Level 3 Inputs reflect management's best estimate of what market participants would use in pricing the asset at the measurement date. It includes prices or valuations that require inputs that are both significant to the fair value measurement and unobservable. Generally, assets carried at fair value and included in this category are debt, warrants and/or other equity investments held in a private company. For loan and debt securities, the Fund has performed a yield analysis assuming a hypothetical current sale of the security. The yield analysis considers changes in interest rates and changes in leverage levels of the portfolio company as compared to the market interest rates and leverage levels. Assuming the credit quality of the portfolio company remains stable, the Fund will use the value determined by the yield analysis as the fair value for that security.

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

Table of Contents

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:

	Fair Value Measurement as of March 31, 2008			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>(in thousands)</i>				
Investments in portfolio securities, at fair value	\$ 80,356	\$	\$	\$ 80,356

A reconciliation of the fair value of investments utilizing significant unobservable inputs is as follows (in thousands):

	Fair value measurements using significant unobservable inputs (Level 3)
Fair value as of December 31, 2007	\$ 72,102
Total realized gains	425
Change in unrealized appreciation	300
Purchases, issuances and settlements, net	7,529
Transfers in (out) of Level 3	
Fair value as of March 31, 2008	\$ 80,356

(5) Related Party Transactions and Agreements

Moore, Clayton & Co., Inc., a Delaware corporation, formed Moore Clayton Capital Advisors, Inc. (MCCA) in February 2005 for the purpose of managing the Fund. Moore, Clayton & Co., Inc., either directly or indirectly has a significant ownership interest in the Fund and, additionally, has one common director. MCCA has no direct ownership in the Fund and has two common directors. MCCA acquired the outstanding stock of the two entities which owned the previous adviser, Equus Capital Management Corporation. Those two entities were individually owned by a current officer of the Fund and a previous officer of the Fund who resigned with the change to the current adviser, Moore Clayton Capital Advisors, Inc.

The Fund entered into an investment advisory agreement dated June 30, 2005 (the Advisory Agreement) with Moore Clayton Capital Advisors, Inc. (the Adviser). This agreement was renewed in June 2007. Pursuant to the Advisory Agreement, the Adviser performs certain investment advisory services that are necessary for the operation of the Fund. The Adviser receives a base advisory fee at an annual rate of 2% of the net assets of the Fund, paid quarterly in arrears, as well as incentive fees in the following amounts: (i) 20% of the excess, if any, of the Fund's net investment income for a quarter that exceeds a quarterly hurdle rate equal to 2% (8% annualized) of the Fund's net assets, and (ii) 20% of the Fund's net realized capital gain less unrealized capital depreciation paid on an annual basis. The advisory fees that the Fund pays represent the Adviser's primary source of revenue. The Adviser is a wholly-owned subsidiary of MCC Global, NV, an international private equity investment and advisory firm.

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

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The Fund also entered into an administration agreement dated June 30, 2005 (Administration Agreement) with Equus Capital Administration Company, Inc. (the Administrator). This agreement was renewed in June 2007. Pursuant to the Administration Agreement, the Administrator provides (or arranges for suitable third parties to provide) all administrative services necessary for the operation of the Fund. The Fund reimburses the Administrator for the costs and expenses incurred by the Administrator in performing its obligations and providing personnel and facilities under the Administrative Agreement, provided that such reimbursements do not exceed \$0.5 million per year.

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

Table of Contents

(6) Contractual Obligations

The Fund has entered into five contracts under which it expects to have material future commitments, including the Advisory Agreement between the Fund and the Adviser, pursuant to which the Adviser has agreed to serve as the Fund's investment advisor; the Administration Agreement between the Fund and the Administrator, pursuant to which the Administrator has agreed to furnish the Fund with the facilities and administrative services necessary to conduct the Fund's day-to-day operations and to provide managerial assistance on its behalf to portfolio companies to which the Fund is required to provide such assistance. The Advisory Agreement and the Administration Agreement may be terminated by either party without penalty upon not more than 60 days' written notice to the other, see Note 5.

The remaining three commitments as of March 31, 2008 relate to the Fund's portfolio company investments and are summarized as follows (in thousands):

Portfolio Company	Original Commitment	Remaining Commitment
RP&C International Investments LLC	\$ 11,100	\$ 7,795
Riptide Entertainment, LLC	10,000	3,500