INTRICON CORP
Form 10-Q
May 17, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2010

or

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

For the transition period from _____ to _____

Commission File Number: 1-5005

INTRICON CORPORATION
(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	**23-1069060** (I.R.S. Employer Identification No.)
1260 Red Fox Road **Arden Hills, Minnesota** (Address of principal executive offices)	**55112** (Zip Code)

(651) 636-9770
(Registrant s telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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.

x Yes o 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).
o Yes o No

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

o Yes x No

The number of outstanding shares of the registrant s common stock, $1.00 par value, on April 26, 2010 was 5,475,248 (net of 515,754 treasury shares).

INTRICON CORPORATION

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PART I: FINANCIAL INFORMATION

ITEM 1. Financial Statements

INTRICON CORPORATION
Consolidated Condensed Balance Sheets
Assets

	March 31, 2010 (Unaudited)	December 31, 2009
Current assets:		
Cash	$ 491,486	$ 385,055
Restricted cash	321,745	405,745
Accounts receivable, less allowance for doubtful accounts of $226,000 at March 31, 2010 and at December 31, 2009	7,570,179	7,083,694
Inventories	8,297,085	8,220,996
Refundable income tax		63,676
Other current assets	598,101	815,742
Current assets of discontinued operations	1,242,312	1,139,813
Total current assets	18,520,908	18,114,721
Machinery and equipment	35,933,986	35,516,164
Less: Accumulated depreciation	29,205,782	28,725,359
Net machinery and equipment	6,728,204	6,790,805
Goodwill	9,708,979	9,716,841
Investment in partnerships	1,225,278	1,237,178
Other assets of discontinued operations	124,245	141,877
Other assets, net	1,438,348	1,361,355
Total assets	$ 37,745,962	$ 37,362,777

(See accompanying notes to the consolidated condensed financial statements)

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INTRICON CORPORATION
Consolidated Condensed Balance Sheets
Liabilities and Shareholders Equity

	March 31, 2010 (Unaudited)	December 31, 2009
Current liabilities:		
Checks written in excess of cash	$ 249,461	$ 101,416
Current maturities of long-term debt	1,714,802	1,708,839
Accounts payable	3,878,749	3,637,329
Income taxes payable	19,628	
Deferred gain	110,084	110,084
Partnership payable	260,000	260,000
Liabilities of discontinued operations	1,034,169	926,409
Other accrued liabilities	3,291,447	2,866,584
Total current liabilities	10,558,340	9,610,661
Long term debt, less current maturities	7,109,030	7,729,797
Other postretirement benefit obligations	738,465	756,000
Long term partnership payable	500,000	500,000
Deferred income taxes	122,753	128,753
Accrued pension liabilities	503,893	543,194
Deferred gain	577,942	605,463
Total liabilities	20,110,423	19,873,868
Commitments and contingencies (note 14)		
Shareholders equity:		
Common shares, $1.00 par value per share; 20,000,000 shares authorized; 5,990,412 and 5,985,862 shares issued; 5,474,658 and 5,470,108 shares outstanding at March 31, 2010 and December 31, 2009, respectively.	5,990,412	5,985,862
Additional paid-in capital	15,118,128	14,986,840
Retained deficit	(1,986,891)	(2,005,187)
Accumulated other comprehensive loss	(221,032)	(213,528)
Less: 515,754 common shares held in treasury, at cost	(1,265,078)	(1,265,078)
Total shareholders equity	17,635,539	17,488,909

Total liabilities and shareholders equity	$ 37,745,962	$ 37,362,777

(See accompanying notes to the consolidated condensed financial statements)

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INTRICON CORPORATION
Consolidated Condensed Statements of Operations
(Unaudited)

	Three Months Ended March 31, 2010 (Unaudited)	Three Months Ended March 31, 2009 (Unaudited)
Sales, net	$ 14,553,464	$ 11,843,962
Cost of sales	10,877,590	9,667,777
Gross profit	3,675,874	2,176,185
Operating expenses:		
Selling expense	786,824	619,035
General and administrative expense	1,443,956	1,378,217
Research and development expense	1,119,093	880,530
Total operating expenses	3,349,873	2,877,782
Operating income (loss)	326,001	(701,597)
Interest expense	(169,718)	(124,914)
Equity in loss of partnerships	(11,900)	(86,948)
Other income, net	44,582	56,755
Income (loss) from continuing operations before income taxes and discontinued operations	188,965	(856,704)
Income tax expense (benefit)	10,691	(49,528)
Income (loss) before discontinued operations	178,274	(807,176)
Loss from discontinued operations, net of income taxes	(159,978)	(182,114)
Net income (loss)	$ 18,296	$ (989,290)
Basic and diluted income (loss) per share:		
Continuing operations	$ 0.03	$ (0.15)
Discontinued operations	$ (0.03)	$ (0.04)
Net income (loss)	$ 0.00	$ (0.19)
Average shares outstanding:		
Basic and diluted	5,470,858	5,343,033

(See accompanying notes to the consolidated condensed financial statements)

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INTRICON CORPORATION
Consolidated Condensed Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31, 2010 (Unaudited)	March 31, 2009 (Unaudited)
Cash flows from operating activities:		
Net income (loss)	$ 18,296	$ (989,290)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	649,128	616,471
Stock-based compensation	118,714	137,454
Loss on disposition of property		1,190
Change in deferred gain	(27,521)	(30,119)
Change in allowance for doubtful accounts	95,603	(104,637)
Equity in loss of partnerships	11,900	86,948
Provision for deferred income taxes	(6,000)	
Changes in operating assets and liabilities:		
Accounts receivable	(663,136)	1,805,311
Inventories	(142,876)	1,788
Other assets	73,195	(307,372)
Accounts payable	241,846	100,057
Accrued expenses	553,751	(875,559)
Other liabilities	41,938	(6,964)
Net cash provided by operating activities	964,838	435,278
Cash flows from investing activities:		
Purchases of property, plant and equipment	(462,229)	(384,238)
Proceeds from note receivable		225,000
Net cash used in investing activities	(462,229)	(159,238)
Cash flows from financing activities:		
Proceeds from long-term borrowings	2,095,155	2,600,370
Repayments of long-term borrowings	(2,709,960)	(2,824,041)
Proceeds from employee stock purchases and exercise of stock options	14,684	30,390
Change in restricted cash	62,355	(1,178)
Change in checks written in excess of cash	148,045	(82,534)
Net cash used in financing activities	(389,721)	(276,993)
Effect of exchange rate changes on cash	(6,457)	(4,645)
Net increase (decrease) in cash	106,431	(5,598)
Cash, beginning of period	385,055	249,396
Cash, end of period	$ 491,486	$ 243,798

(See accompanying notes to the consolidated condensed financial statements)

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Notes to Consolidated Condensed Financial Statements (Unaudited)

1. General

In the opinion of management, the accompanying consolidated condensed financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly IntriCon Corporation s (IntriCon or the Company) consolidated financial position as of March 31, 2010 and December 31, 2009, and the consolidated results of its operations for the three months ended March 31, 2010 and 2009. Results of operations for the interim period are not necessarily indicators of the results of the operations expected for the full year or any other interim period.

On January 1, 2010, the Company purchased the remaining 10 percent minority interest of its German subsidiary for approximately $18,000. The non-controlling interest was immaterial for all periods presented.

Segment Disclosures A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. The Company s segments have similar economic characteristics and are similar in the nature of the products sold, type of customers, methods used to distribute the Company s products and regulatory environment. Management believes that the Company meets the criteria for aggregating its operating segments of its continuing operations into a single reporting segment.

The Company has evaluated subsequent events through the date of this filing and has appropriately included all matters requiring disclosures herein.

2. New Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements, which amends Accounting Standards Codification (ASC) 820, Fair Value Measurements, by requiring additional disclosures for transfers in and out of levels 1 and 2 and activity in level 3 fair value measurements. Additionally, the amendment clarifies existing disclosure requirements surrounding the level of disaggregation and valuation techniques and inputs. This guidance became effective for us January 1, 2010 and did not have a material impact on our consolidated financial statements.

3. Discontinued Operations

In December 2009, the Company s Board of Directors authorized management to exit the non-core electronics products segment operated by its wholly-owned subsidiary, RTI Electronics, Inc. and divest the assets used in the business. The decision to exit the electronics products segment was made to allow the Company to focus on its core body-worn device segment and to improve the Company s overall margins and profitability. In connection with its decision to divest the electronics business, the Company evaluated assets for impairment and costs of terminating employees and recorded the following: (i) an impairment charge of $685,000 relating to goodwill, (ii) a reduction to realizable value of $720,000 to tangible assets, and (iii) $275,000 in employee termination costs for the year ended December 31, 2009. Additional costs related to employee terminations of $92,500 were recorded during the three months ended March 31, 2010. Additional future employee termination costs are expected to be approximately $90,000 in 2010.

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The following table shows the results of operations of the Company s electronic products segment (in thousands):

	Three Months Ended March 31, 2010	2009
Sales, net	$ 1,362	$ 1,486
Operating costs and expenses	(1,519)	(1,650)
Operating loss	(157)	(164)
Other expense, net	(3)	(3)
Loss from operations before income tax expense	(160)	(167)
Income tax expense		15
Net loss from discontinued operations	$ (160)	$ (182)

The following table shows the assets and liabilities of the electronic products segment at March 31, 2010 and December 31, 2009 (in thousands):

	2010	2009
Cash	$ 4	$ 5
Accounts receivable, net	801	757
Inventory, net	396	332
Other current assets	41	46
Current assets of discontinued operations	1,242	1,140
Property and equipment, net	98	116
Other assets of discontinued operations	26	26
Accounts payable	346	351
Accrued compensation and other liabilities	688	575
Current liabilities of discontinued operations	$ 1,034	$ 926

Information regarding the nonrecurring fair value measurement completed during the three month period ended December 31, 2009 was as follows:

2009 (in thousands):	Fair Value as of measurement date	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Impairment Charge
Long-lived assets and goodwill of discontinued operations	$ 116	$	$	$ 116	$ 910

There were no additional impairments identified for the three months ended March 31, 2010.

4. Acquisition

On August 13, 2009, the Company acquired all of the outstanding stock of Jon Barron, Inc. doing business as Datrix (Datrix), a privately held developer, manufacturer, tester and marketer of medical devices and related software products, based in Escondido, California. The acquisition provided the Company entry into the ambulatory electrocardiograph (AECG) and event recording markets.

The purchase price included a closing cash payment of $1,225,000, issuance of 75,000 shares of restricted common stock of the Company, valued at $270,000 based on the fair value of the common stock on August 13, 2009, and the issuance of a promissory note in the amount of $1,050,000 bearing annual interest at 6%, subject to adjustment. In addition, the Company paid off Datrix s outstanding line of credit with Wells Fargo of $130,000 at closing.

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The principal amount of the promissory note is payable in three installments of $350,000 on August 13, 2010, August 13, 2011 and August 13, 2012. The note bears annual interest at 6% and is payable with each installment of principal as set forth above.

The assets and liabilities of Datrix were recorded as of the acquisition date at their respective fair values and consolidated with those of the Company. Likewise, the results of operations of the Datrix operations since August 13, 2009 have been included in the accompanying consolidated statements of operations. The allocation of the net purchase price of the acquisition resulted in goodwill of approximately $2,128,000. The goodwill represents operating and market synergies that the Company expects to be realized as a result of the acquisition and future opportunities and is not tax deductible. The purchase price allocation is based on estimates of fair values of assets acquired and liabilities assumed. The valuation required the use of significant assumptions and estimates. These estimates were based on assumptions the Company believed to be reasonable.

The purchase price was as follows as of August 13, 2009 (amounts in thousands):

Cash paid to seller at closing	$	1,225
Cash paid to Wells Fargo at closing		130
Stock consideration		270
Seller note at close		1,050
Total purchase price	$	2,675

The following table summarizes the purchase price allocation for the Datrix acquisition (amounts in thousands):

Cash	$	13
Other current assets		522
Intangible assets (weighted average life of 2.4 years)		125
Goodwill Body-Worn Segment		2,128
Current liabilities		(113)
Total preliminary purchase price allocation	$	2,675

Results from operations of Datrix are not considered material to the financial statements for 2009. Proforma results are also not considered material for 2009. Acquisition costs of $277,000 were primarily incurred and recorded in the three month period ended September 30, 2009.

5. Product Warranty

In general, the Company warrants its products to be free from defects in material and workmanship and will fully conform to and perform to specifications for a period of one year. The following table presents changes in the Company s warranty liability for the three months ended March 31, 2010:

		Three months ended March 31, 2010
Beginning balance (December 31, 2009)	$	70,700
Warranty expense		27,700
Closed warranty claims		
Ending balance (March 31, 2010)	$	98,400

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6. Geographic Information

The geographical distribution of long-lived assets to geographical areas consisted of the following at:

	March 31, 2010	December 31, 2009
United States	$ 5,636,000	$ 5,893,000
Other	1,187,000	1,229,000
Consolidated	$ 6,823,000	$ 7,122,000

Long-lived assets consist of property and equipment as they are difficult to move and relatively illiquid. Excluded from long-lived assets are investments in partnerships, patents, license agreements and goodwill. The Company capitalizes long-lived assets pertaining to the production of specialized parts. These assets are periodically reviewed to assure the net realizable value from the estimated future production based on forecasted cash flows exceeds the carrying value of the assets.

The geographical distribution of net sales to geographical areas for the three months ended March 31, 2010 and 2009 were as follows:

	Three months ended	
	March 31, 2010	March 31, 2009
Net Sales to Geographical Areas:		
United States	$ 10,022,135	$ 8,380,328
Germany	887,381	572,849
China	839,557	532,923
Switzerland	201,518	162,611
Japan	267,589	424,175
France	394,588	422,988
Singapore	459,950	299,899
United Kingdom	76,811	150,019
Vietnam	272,993	163,703
Hong Kong	175,548	150,896
All other countries	955,394	583,571
Consolidated	$ 14,553,464	$ 11,843,962

Geographic net sales are allocated based on the location of the customer. All other countries include net sales primarily to various countries in Europe and in the Asian Pacific.

For the three months ended March 31, 2010, one customer accounted for 24 percent of the Company s consolidated net sales. For the three months ended March 31, 2009, two customers accounted for 16 percent and 13 percent of the Company s consolidated net sales, respectively.

At March 31, 2010, two customers accounted for 11 percent and 10 percent of the Company s consolidated accounts receivable, respectively. At December 31, 2009, two customers accounted for 16 percent and 11 percent of the Company s consolidated accounts receivable, respectively.

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7. Inventories

Inventories consisted of the following at:

	Raw materials	Work-in process	Finished products and components	Total
March 31, 2010				
Domestic	$ 3,543,699	$ 1,638,338	$ 1,092,801	$ 6,274,838
Foreign	1,366,626	398,319	257,302	2,022,247
Total	$ 4,910,326	$ 2,036,657	$ 1,350,103	$ 8,297,085
December 31, 2009				
Domestic	$ 3,650,572	$ 1,679,985	$ 934,554	$ 6,265,111
Foreign	1,515,502	216,577	223,806	1,955,885
Total	$ 5,166,074	$ 1,896,562	$ 1,158,360	$ 8,220,996

8. Short and Long Term Debt

Short and long term debt is summarized as follows:

	March 31, 2010	December 31, 2009
Domestic Asset-Based Revolving Credit Facility	$ 3,985,000	$ 4,450,000
Foreign Overdraft and Letter of Credit Facility	708,000	678,000
Domestic Term Loan	3,075,000	3,250,000
Domestic Capital Equipment Leases	6,000	11,000
Note Payable Datrix Purchase	1,050,000	1,050,000
Total Debt	8,824,000	9,439,000
Less: Current maturities	(1,715,000)	(1,709,000)
Total Long Term Debt	$ 7,109,000	$ 7,730,000

To finance a portion of the Datrix acquisition and replace the Company s existing credit facilities with Bank of America, including capital leases, the Company and its domestic subsidiaries entered into a new three year credit facility with The PrivateBank and Trust Company on August 13, 2009. The credit facility provides for:

§ an $8,000,000 revolving credit facility, with a $200,000 subfacility for letters of credit. Under the revolving credit facility, the availability of funds depends on a borrowing base composed of stated percentages of the Company s eligible trade receivables and eligible inventory, and eligible equipment less a reserve; and

§ a $3,500,000 term loan.

Loans under the credit facility are secured by a security interest in substantially all of the assets of the Company and its domestic subsidiaries including a pledge of the stock of its domestic subsidiaries. Loans under the credit facility bear interest at varying rates based on predefined levels of Funded Debt / EBITDA, at the option of the Company, at:

§ the London InterBank Offered Rate (LIBOR) plus 3.00% - 4.00%, or

§ the base rate, which is the higher of (a) the rate publicly announced from time to time by the lender as its prime rate and (b) the Federal Funds Rate plus 0.5%, plus 0.25% - 1.25%.

Weighted average interest on the new domestic asset-based revolving credit facility was 4.41% for the three months ended March 31, 2010 and 4.07% for the year ended December 31, 2009. The outstanding balance of the revolving credit facility was $3,985,000 and $4,450,000 at March 31, 2010 and December 31, 2009, respectively. The total remaining availability on the revolving credit facility was approximately $2,796,000 and $2,821,000 at March 31, 2010 and December 31, 2009, respectively.

The outstanding principal balance of the term loan is payable in quarterly installments of varying amounts ranging from $168,750 to $187,500. Any remaining principal and accrued interest is payable on August 13, 2012. IntriCon is also required to use 100% of the net cash proceeds of certain asset sales (excluding inventory and certain other dispositions), sale of capital securities or issuance of debt to pay down the term loan.

In March 2010, the Company entered into an amendment with the PrivateBank to waive certain covenant violations at December 31, 2009 and January 31, 2010 and reset certain covenant thresholds defined in the original agreement. The Company was in compliance with all applicable covenants under the credit facility, as amended, as of March 31, 2010.

Upon termination of the Bank of America credit facility, the Company was required to settle the outstanding obligations of $121,000 for the liability related to its interest rate swap agreement with Bank of America and recognize the corresponding charge of $121,000 in interest expense in the three month period ended September 30, 2009, which was previously included in accumulated other comprehensive loss. In addition, the Company expensed the remaining deferred financing costs of $86,000 related to the Bank of America facility, which was also included in interest expense in the three month period ended September 30, 2009.

The prior credit facility provided for:

§ a $10,000,000 revolving credit facility, with a $200,000 subfacility for letters of credit. Under the revolving credit facility, the availability of funds depends on a borrowing base composed of stated percentages of our eligible trade receivables and eligible inventory, less a reserve.

§ a $4,500,000 term loan, which was used to fund the Company s May, 2007 acquisition of Tibbetts Industries, Inc.

Loans under the credit facility were secured by a security interest in substantially all of the assets of the borrowers including a pledge of the stock of the subsidiaries. All of the borrowers were jointly and severally liable for all borrowings under the credit facility.

In June 2008, the Company completed a sale-leaseback of machinery and equipment with Bank of America. The transaction generated proceeds of $1,098,000, of which $1,013,000 was used to pay down the domestic term loan. The facility was repaid on August 13, 2009 with proceeds borrowed under the new PrivateBank facility.

In addition to its domestic credit facilities, the Company s wholly-owned subsidiary, IntriCon, PTE LTD., entered into an international senior secured credit agreement with Oversea-Chinese Banking Corporation Ltd. that provides for a $1.8 million line of credit. Borrowings bear interest at a rate of .75% to 2.5% over the lender s prevailing prime lending rate. Weighted average interest on the international credit facilities was 4.04% for the three months ended March 31, 2010 and the outstanding balance was $708,000 and $678,000 at March 31, 2010 and December 31, 2009, respectively. The total remaining availability on the international senior secured credit agreement was approximately $1,150,000 and $1,177,000 at March 31, 2010 and December 31, 2009, respectively.

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9. Income Taxes

Income tax expense for the three months ended March 31, 2010 was $11,000 compared to benefit of $50,000 for the same period in 2009. The expense (benefit) for the three months ended March 31, 2010 and 2009 were primarily due to foreign operating income (loss). The Company has net operating loss carryforwards for U.S. federal income tax purposes and, consequently, minimal federal benefit or expense from the domestic operations was recognized as the deferred tax asset has a full valuation allowance.

The following was the income (loss) before income taxes for each jurisdiction that the Company has operations for the three months ended March 31, 2010 and 2009:

	Three months ended	
	March 31, 2010	March 31, 2009
United States	$ 157,879	$ (596,219)
Singapore	(26,090)	(220,393)
Germany	51,176	(40,092)
Income (loss) before income taxes and discontinued operations	$ 188,965	$ (856,704)

10. Stockholders Equity and Stock-based Compensation

The Company has a 1994 stock option plan, a 2001 stock option plan, a non-employee directors stock option plan and a 2006 equity incentive plan. New grants may not be made under the 1994, the 2001 and the non-employee directors stock option plans; however certain option grants under these plans remain exercisable as of March 31, 2010. The aggregate number of shares of common stock for which awards could be granted under the 2006 Equity Incentive Plan as of the date of adoption was 698,500 shares. Additionally, as outstanding options under the 2001 stock option plan and non-employee directors stock option plan expire, the shares of the Company s common stock subject to the expired options will become available for issuance under the 2006 Equity Incentive Plan. On April 21, 2010, the Company s shareholders approved an amendment to the 2006 Equity Incentive Plan to increase (i) the authorized number of shares of the Company s common stock reserved and issuable under the plan by an additional 250,000 shares and (ii) the maximum number of incentive stock options that may be granted under the plan to be the same as the maximum number of shares that may be granted under the plan. The amendment was approved by the Company s board of directors in March, 2010 and subsequently approved by shareholders.

Under the various plans, executives, employees and outside directors receive awards of options to purchase common stock. Under the 2006 Equity Incentive Plan, the Company may also grant stock awards, stock appreciation rights, restricted stock units and other equity-based awards, although no such awards, other than awards under the programs discussed in the next two paragraphs, had been granted as of March 31, 2010. Under all awards, the terms are fixed on the grant date. Generally, the exercise price equals the market price of the Company s stock on the date of the grant. Options under the plans generally vest over three years, and have a maximum term of 10 years.

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Additionally, the board has established the non-employee directors stock fee election program, referred to as the director program, as an award under the 2006 equity incentive plan. The director program gives each non-employee director the right under the 2006 equity incentive plan to elect to have some or all of his quarterly director fees paid in common shares rather than cash. There were 785 and 827 shares issued in lieu of cash for director fees under the director program for the three months ended March 31, 2010 and 2009, respectively.

On July 23, 2008, the Compensation Committee of the Board of Directors approved the non-employee director and executive officer stock purchase program, referred to as the management purchase program, as an award under the 2006 Plan. The purpose of the management purchase program is to permit the Company s non-employee directors and executive officers to purchase shares of the Company s common stock directly from the Company. Pursuant to the management purchase program, as amended, participants may elect to purchase shares of common stock from the Company not exceeding an aggregate of $100,000 during any fiscal year. Participants may make such election one time during each twenty business day period following the public release of the Company s earnings announcement, referred to as a window period, and only if such participant is not in possession of material, non-public information concerning the Company, subject to the discretion of the Board to prohibit any transactions in common stock by directors and executive officers during a window period. There were no shares purchased under the management purchase program during the three months ended March 31, 2010 and 2009, respectively.

Stock option activity as of and during the three months ended March 31, 2010 was as follows:

	Number of Shares	Weighted-average Exercise Price	Aggregate Intrinsic Value
Outstanding at December 31, 2009	1,053,800	$ 5.67	
Options forfeited			
Options granted	85,000	3.16	
Options exercised			
Outstanding at March 31, 2010	1,138,800	$ 5.49	$
Exercisable at March 31, 2010	822,100	$ 5.28	$
Available for future grant at December 31, 2009	161,404		
Available for future grant at March 31, 2010	75,814		

The number of shares available for future grant at March 31, 2010 does not include a total of up to 397,700 shares subject to options outstanding under the 2001 stock option plan and non-employee directors stock option plan as of March 31, 2010, which will become available for grant under the 2006 Equity Incentive Plan in the event of the expiration of such options.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of subjective assumptions, including the expected stock price volatility. Because the Company s options have characteristics different from those of traded options, in the opinion of management, the existing models do not necessarily provide a reliable single measure of the fair value of its options. The weighted average fair value of options granted was $1.71, respectively, for options granted during the three months ended March 31, 2010. The weighted average fair value of options granted was $1.83 for options granted during the three months ended March 31, 2009.

The Company calculates expected volatility for stock options and awards using both historical volatility as well as the average volatility of our peer competitors. The Company s historical volatility is not the sole input due to the material changes in the Company s operations as a result of the sales of business segments that occurred in 2005 and May 2010.

The Company currently estimates a nine percent forfeiture rate for stock options, but will continue to review this estimate in future periods.

The Company also has an Employee Stock Purchase Plan (the Purchase Plan). A maximum of 100,000 shares may be sold under the Purchase Plan. There were 3,765 shares purchased under the plan for the three months ended March 31, 2010 and a total of 9,740 shares purchased for the three months ended March 31, 2009.

The risk-free rates for the expected terms of the stock options and awards and the Purchase Plan is based on the U.S. Treasury yield curve in effect at the time of grant.

The weighted average remaining contractual life of options exercisable at March 31, 2010 was 5.1 years.

The Company recorded $119,000 and $137,000 of non-cash stock option expense for the three months ended March 31, 2010 and 2009, respectively. As of March 31, 2010, there was $560,000 of total unrecognized compensation costs related to non-vested awards that are expected to be recognized over a weighted-average period of 1.4 years.

11. Income Per Share

The following table presents a reconciliation between basic and diluted earnings per share:

	Three months ended March 31, 2010	Three months ended March 31, 2009
Numerators:		
Income (loss) before discontinued operations	$ 178,274	$ (807,176)
Loss from discontinued operations, net of taxes	(159,978)	(182,114)
Net income (loss)	$ 18,296	$ (989,290)
Denominator:		
Basic weighted shares outstanding	5,470,858	5,343,033
Weighted shares assumed upon exercise of stock options		
Diluted weighted shares outstanding	5,470,858	5,343,033
Basic and diluted (loss) earnings per share:		
Continuing operations	$ 0.03	$ (0.15)
Discontinued operations	(0.03)	(0.04)
Basic and diluted (loss) earnings per share:	$ 0.00	$ (0.19)

The dilutive impact summarized above relates to the periods when the average market price of Company stock exceeded the exercise price of the potentially dilutive option securities granted. Earnings per common share was based on the weighted average number of common shares outstanding during the periods when computing the basic earnings per share. When dilutive, stock options are included as equivalents using the treasury stock market method when computing the diluted earnings per share.

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Excluded from the computation of diluted earnings per share for the three months ended March 31, 2010 and 2009, were options out of the money with rights to purchase approximately 651,100 and 990,650 common shares, respectively, with an average exercise price of $7.61 and $5.86, respectively, because the effect would have been anti-dilutive.

12. Derivative Financial Instruments

Derivative financial instruments are used by the Company in the management of its interest rate and foreign currency exposure. There were no foreign currency derivative financial instruments for the periods presented. The Company does not hold or issue derivative financial instruments for trading purposes. When entered into, the Company formally designates the derivative financial instrument as a hedge of a specific underlying exposure if such criteria are met, and documents both the risk management objectives and strategies for undertaking the hedge. The Company formally assesses, both at inception and at least quarterly thereafter, whether the derivative financial instruments that are used in hedging transactions are effective at offsetting changes in either the fair value or cash flows of the related underlying exposure. Because of the high correlation between the derivative financial instrument and the underlying exposure being hedged, fluctuations in the value of the derivative financial instruments are generally offset by changes in the fair values or cash flows of the underlying exposures being hedged. Any ineffective portion of a derivative financial instrument s change in fair value is immediately recognized in earnings.

The Company uses interest rate swaps to manage its interest rate risk. The swaps are designated as cash flow hedges with the changes in fair value recorded in accumulated other comprehensive loss and as a derivative hedge asset or liability, as applicable. The swaps settle periodically in arrears with the related amounts for the current settlement period payable to, or receivable from, the counter-parties included in accrued liabilities or accounts receivable and recognized in earnings as an adjustment to interest expense from the underlying debt to which the swap is designated.

Upon termination of the Bank of America credit facility, the Company was required to settle the outstanding obligations of $121,000 for the liability related to its interest rate swap agreement with Bank of America and recognize the corresponding charge of $121,000 in interest expense in the three month period ended September 30, 2009, which was previously included in other comprehensive income.

In conjunction with the new credit facility, the Company entered into an interest rate swap agreement with The Private Bank and Trust Company. At March 31, 2010, the Company had a United States Dollar (USD) denominated interest rate swap outstanding which effectively fixed the interest rate on floating rate debt, exclusive of lender spreads, at 5.36% for a notional principal amount of $2,000,000 through September 2010.

Interest rate swaps, which are considered derivative instruments, of $0 and $35,000 are reported on the balance sheet at fair value in other current liabilities at March 31, 2010 and December 31, 2009, respectively.

13. Comprehensive Income (Loss)

The components of comprehensive (loss) income were as follows:

	Three months ended	
	March 31, 2010	**March 31, 2009**
Net income (loss)	$ 18,296	$ (989,290)
Change in fair value of interest rate swap	34,600	12,256
(Loss) gain on foreign currency translation adjustment	(42,104)	(26,468)
Comprehensive (loss) income	$ 10,792	$ (1,003,502)

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14. Legal Proceedings

We are a defendant along with a number of other parties in approximately 122 lawsuits as of March 31, 2010, (approximately 122 lawsuits as of December 31, 2009) alleging that plaintiffs have or may have contracted asbestos-related diseases as a result of exposure to asbestos products or equipment containing asbestos sold by one or more named defendants. Due to the noninformative nature of the complaints, we do not know whether any of the complaints state valid claims against us. Certain insurance carriers have informed us that the primary policies for the period August 1, 1970-1973, have been exhausted and that the carriers will no longer provide a defense under those policies. We have requested that the carriers substantiate this situation. We believe we have additional policies available for other years which have been ignored by the carriers. Because settlement payments are applied to all years a litigant was deemed to have been exposed to asbestos, we believe when settlement payments are applied to these additional policies, we will have availability under the years deemed exhausted. We do not believe that the asserted exhaustion of the primary insurance coverage for this period will have a material adverse effect on our financial condition, liquidity, or results of operations. Management believes that the number of insurance carriers involved in the defense of the suits and the significant number of policy years and policy limits, to which these insurance carriers are insuring us, make the ultimate disposition of these lawsuits not material to our consolidated financial position or results of operations.

The Company s former wholly owned French subsidiary, Selas SAS, filed for insolvency in France and is being managed by a court appointed administrator. The Company may be subject to additional litigation or liabilities as a result of the French insolvency proceeding.

We are also involved in other lawsuits arising in the normal course of business. While it is not possible to predict with certainty the outcome of these matters, management is of the opinion that the disposition of these lawsuits and claims will not materially affect our consolidated financial position, liquidity or results of operations.

15. Related-Party Transactions

One of the Company s subsidiaries leases office and factory space from a partnership consisting of three present or former officers of the subsidiary, including Mark Gorder, a member of the Company s Board of Directors and the President and Chief Executive Officer of the Company. The subsidiary is required to pay all real estate taxes and operating expenses. In the opinion of management, the terms of the lease agreement are comparable to those which could be obtained from unaffiliated third parties. The total base rent expense, real estate taxes and other charges incurred under the lease was approximately $121,000 and $119,000 for each of the three months ended March 31, 2010 and 2009, respectively. Annual lease commitments, which include base rent expense, real estate taxes and other charges, approximate $477,000 through October 2011.

The Company uses the law firm of Blank Rome LLP for legal services. A partner of that firm is the son-in-law of the Chairman of the Company s Board of Directors. For the three months ended March 31, 2010 and 2009, the Company paid that firm approximately $16,000 and $20,000, respectively, for legal services and costs. The Chairman of our Board of Directors is considered independent under applicable Nasdaq and SEC rules because (i) no payments were made to the Chairman or the partner directly in exchange for the services provided by the law firm and (ii) the amounts paid to the law firm did not exceed the thresholds contained in the Nasdaq standards. Furthermore, the aforementioned partner does not provide any legal services to the Company and is not involved in billing matters.

16. Statements of Cash Flows

The following table provides supplemental disclosures of cash flow information:

	Three months ended March 31, 2010	Three months ended March 31, 2009
Interest received	$ 304	$ 439
Interest paid	114,474	79,921
Income taxes paid	6,537	75,784

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17. Investment in Partnerships

The Company owns a 9% partnership interest in the Hearing Instrument Manufacturers Patent Partnership (HIMPP), and is a party to a license agreement that grants the Company access to over 45 US registered patents. The Company recorded a $37,000 decrease in the carrying amount of the investment, reflecting amortization of the patents, other intangibles and the Company s portion of the partnership s operating results for each of the three months ended March 31, 2010 and 2009, respectively.

The Company s subsidiary, IntriCon Tibbetts Corporation, owns a 50% interest in a joint venture with a Swiss company to market, design, manufacture, and sell audio coils to the hearing health industry. The Company has recorded a $25,000 increase and a $50,000 decrease in the carrying amount of the investment, reflecting the Company s portion of the joint venture s operating results for the three months ended March 31, 2010 and 2009, respectively.

Condensed financial information of the unaudited joint venture was as follows:

	March 31, 2010	December 31, 2009
Balance Sheet:		
Current assets	$ 806,000	$ 833,000
Non-current assets	262,000	224,000
Total assets	$ 1,068,000	$ 1,057,000
Current liabilities	565,000	604,000
Non-current liabilities		
Stockholders equity	503,000	453,000
Total liabilities and stockholders equity	$ 1,068,000	$ 1,057,000

	Three Months Ended	
	March 31, 2010	March 31, 2009
Income Statement:		
Net revenues	$ 839,000	$ 446,000
Net income (loss)	$ 50,000	$ (100,000)

18. Revenue by Market

The following tables set forth, for the periods indicated, net revenue by market:

	Three Months Ended	
	March 31, 2010	March 31, 2009
Hearing Health	$ 5,370,000	$ 4,411,000
Medical	6,508,000	5,285,000
Professional Audio Communications	2,675,000	2,148,000
Total Revenue	$ 14,553,000	$ 11,844,000

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ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Business Overview

Headquartered in Arden Hills, Minnesota, IntriCon Corporation (together with its subsidiaries referred to as the Company , IntriCon, we , us our) is an international firm engaged in designing, developing, engineering and manufacturing body-worn devices.

In addition to its operations in Minnesota, the Company has facilities in Maine, Singapore and Germany.

Currently, the Company operates in one business segment, the body-worn device segment. In 2009, the Company decided to exit its non-core electronic products segment, to allow for greater focus on its body-worn device segment. The Company is in the process of disposing the assets relating to the electronic products segment. For all periods presented, the Company classified its former electronics products segment as discontinued operations.

Market Overview: Body-Worn Devices

Products and Industries Served

IntriCon designs, develops and manufactures miniature and micro-miniature body-worn products based on its proprietary technology to meet the rising demand for smaller, portable and more advanced devices. Our expertise is focused on three main markets: medical, hearing health and professional audio communications. Within these chosen markets, we combine ultra-miniature mechanical and electronics capabilities with proprietary technology including ultra low power (ULP) wireless and digital signal processing (DSP) capabilities that enhances the performance of body-worn devices.

Medical

In the medical market, the Company is focused on sales of multiple bio-telemetry devices from life-critical diagnostic monitoring devices to drug-delivery systems. Using our nanoDSP and ULP nanoLink technology, the Company manufactures microelectronics, micro-mechanical assemblies, high-precision injection-molded plastic components and complete bio-telemetry devices for emerging and leading medical device manufacturers. Targeted customers include medical product manufacturers of portable and lightweight battery powered devices, as well as a variety of sensors designed to connect a patient to an electronic device.

The medical industry is faced with pressures to reduce the costs of healthcare. IntriCon currently serves this market by offering medical manufacturers the capabilities to design, develop and manufacture components for medical devices that are easier to use, more miniature, use less power, and lighter. These devices measure with greater accuracy and provide more functions while reducing the costs to manufacture these devices. IntriCon manufactures and supplies bubble sensors and flow restrictors that monitor and control the flow of fluid in an intravenous infusion system. IntriCon also manufactures a family of safety needle products for an OEM customer that utilizes IntriCon s insert and straight molding capabilities. These products are assembled using full automation, including built-in quality checks within the production lines. Other examples include sensors used to detect pathologies in specific organs of the body and monitoring devices to detect cardiac, respiratory functions, and blood glucose levels. The early and accurate detection of pathologies allows for increased likelihood for successful treatment of chronic diseases and cancers. Accurate monitoring of multiple functions of the body, such as heart rate, breathing and blood glucose levels, aids in generating more accurate diagnosis and treatments for patients.

In addition, there has been an industry-wide trend toward further miniaturization and ambulatory operation enabled by wireless connectivity, which is also referred to as bio-telemetry. Through the further development of our ULP BodyNet family, a series of wirelessly enabled products including our new wireless nanoLink and physioLink families, we believe the bio-telemetry offers a significant future opportunity. Increasingly, the medical industry is looking for wireless, low-power capabilities in their devices. We believe our strategic partnership with Advanced Medical Electronics Corp. (AME) will allow us to develop new bio-telemetry devices that better connect patients and care givers, providing critical information and feedback. Current examples of IntriCon bio-telemetry products used by medical device manufacturers include components found in wireless glucose sensor pumps that introduce drugs into the bloodstream. In 2009, we also entered the cardiac diagnostic monitoring (CDM) market with our acquisition of Datrix, a supplier of patient monitoring devices. We are leveraging Datrix s cardiac monitoring capabilities and incorporating IntriCon s core competencies to develop and launch a new line of CDM devices, including a wireless CDM device that we call Centauri (formerly referred to as MPETS), which we anticipate will be available for sale later in 2010.

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Hearing Health

IntriCon manufactures hybrid amplifiers and integrated circuit components (hybrid amplifiers), along with faceplates for in-the-ear and in-the-canal hearing instruments. IntriCon is a leading manufacturer and supplier of microminiature electromechanical components to hearing instrument manufacturers. These components consist of volume controls, microphones, receivers, trimmer potentiometers and switches. Components are offered in a variety of sizes, colors and capacities in order to accommodate a hearing manufacturer s individualized specifications.

Hearing instruments, which fit behind or in a person s ear to amplify and process sound for a hearing impaired person, generally are composed of four basic parts and several supplemental components for control or fitting purposes. The four basic parts are microphones, amplifier circuits, miniature receivers/speakers and batteries, all of which IntriCon manufactures, with the exception of the battery. IntriCon s hybrid amplifiers are a type of amplifier circuit. Supplemental components include volume controls, trimmer potentiometers, which shape sound frequencies to respond to the particular nature of a person s hearing loss, and switches used to turn the instrument on and off and to go from telephone to normal speech modes. Faceplates and an ear shell, molded to fit the user s ear, often serve as housing for hearing instruments. IntriCon manufactures its components on a short lead-time basis in order to supply just-in-time delivery to its customers and, consequently, order backlog amounts are not meaningful.

Using our ULP BodyNet family technology, specifically nanoDSP and our new wireless nanoLink and physioLink technologies, IntriCon is building a new generation of affordable, high-quality hearing aids and similar amplifier devices under contracts for OEM s. DSP devices have better clarity, attractive pricing points and an improved ability to filter out background noise. During 2009, we introduced our Scenic DSP amplifier with acoustic scene analysis, our new high-performance adaptive DSP hearing instrument amplifier. In our view, Scenic advanced capabilities are ideally suited for the hearing health market. Additionally, in 2010 we introduced the Overtus DSP amplifier. The Overtus DSP amplifier is designed to optimize open in the canal (ITC) type fittings. The amplifier algorithm contains two patented features, an advanced adaptive feedback canceller optimized for open ITC fittings and an acoustic switch eliminating the need for a mechanical switch and allowing for further miniaturization. We believe the introduction of both Scenic and Overtus solidifies our position as a leader of high-performance adaptive DSP hearing instrument amplifiers. Furthermore, we believe our strategic alliance with Dynamic Hearing will allow us to develop new body-worn applications and further expand both our hearing health and professional audio product portfolio.

Overall, we believe the hearing health market holds significant opportunities for the Company. In the United States, Europe and Japan, the 65-year-old-plus age demographic is the fastest growing segment of the population, and many of those individuals could, at some point, benefit from a hearing device that uses IntriCon s proprietary technology.

While it harbors great potential, the hearing health market is experiencing slowness due to macroeconomic conditions. In general, the U.S. market does not provide insurance reimbursement for hearing aid purchases. People can defer their hearing aid purchase. We believe the hearing health market will experience slow, steady growth in 2010. Reimbursement trends in Europe are more favorable, with insurers and the governments covering more devices.

Professional Audio Communications

IntriCon entered the high-quality audio communication device market in 2001, and now has a line of miniature, professional audio headset products used by customers focusing on homeland security and emergency response needs. The line includes several communication devices that are extremely portable and perform well in noisy or hazardous environments. These products are well suited for applications in the fire, law enforcement, safety, aviation and military markets. In addition, the Company has a line of miniature ear- and head-worn devices used by performers and support staff in the music and stage performance markets. Our May 2007 acquisition of Tibbetts Industries provided the Company access to homeland security agencies in this market. We believe performance in difficult listening environments and wireless operations will continue to improve as these products increasingly include our proprietary nanoDSP , wireless nanoLink and physioLink technologies.

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In 2010, we plan to introduce a line of situational listening devices (SLD s) intended to help hearing impaired people hear in noisy environments like restaurants and automobiles, and to listen to television and music by direct wireless connection. Such devices are intended to be supplements to their conventional hearing aids, which do not handle those situations well. The SLD s will be based on our ULP wireless nanoLink technology and our physioLink technology, which was recently demonstrated at the annual convention of the American Academy of Audiology. The product line consists of an earpiece, TV transmitter, companion microphone, iPod/iPhone transmitter, and USB transmitter.

Forward-Looking and Cautionary Statements

Certain statements included in this Quarterly Report on Form 10-Q or documents the Company files with the Securities and Exchange Commission, which are not historical facts, or that include forward-looking terminology such as may , will , believe , expect , should , optimi continue or the negative thereof or other variations thereof, are forward-looking statements (as such term is defined in Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933, and the regulations thereunder), which are intended to be covered by the safe harbors created thereby. These statements may include, but are not limited to statements in Management s Discussion and Analysis of Financial Condition and Results of Operations and Notes to the Company s Condensed Consolidated Financial Statements such as net operating loss carryforwards, the ability to meet cash requirements for operating needs, the ability to meet liquidity needs, assumptions used to calculate future level of funding of employee benefit plans, the adequacy of insurance coverage, the impact of new accounting pronouncements and litigation.

Forward-looking statements also include, without limitation, statements as to the Company s expected future results of operations and growth, the Company s ability to meet working capital requirements, the Company s business strategy, the expected increases in operating efficiencies, anticipated trends in the Company s markets, estimates of goodwill impairments and amortization expense of other intangible assets, the effects of changes in accounting pronouncements, the effects of litigation and the amount of insurance coverage, and statements as to trends or the Company s or management s beliefs, expectations and opinions.

Forward-looking statements are subject to risks and uncertainties and may be affected by various factors that may cause actual results to differ materially from those in the forward-looking statements. In addition to the factors discussed in this Quarterly Report on Form 10-Q, certain risks, uncertainties and other factors can cause actual results and developments to be materially different from those expressed or implied by such forward-looking statements, including, without limitation, the following:

§ the ability to successfully implement the Company s business and growth strategy;

§ risks arising in connection with the insolvency of our former subsidiary, Selas SAS, and potential liabilities and actions arising in connection therewith;

§ the volume and timing of orders received by the Company;

§ changes in estimated future cash flows;

§ ability to collect on our accounts receivable;

§ foreign currency movements in markets the Company services;

§ changes in the global economy and financial markets;

§ weakening demand for the Company s products due to general economic conditions;

§ changes in the mix of products sold;

§ ability to meet demand;

§ changes in customer requirements;

§ timing and extent of research and development expenses;

§ acceptance of the Company s products;

- competitive pricing pressures;
- pending and potential future litigation;
- cost and availability of electronic components and commodities for the Company s products;
- ability to create and market products in a timely manner and develop products that are inexpensive to manufacture;
- ability to comply with covenants in our debt agreements;
- ability to repay debt when it comes due;
- the loss of one or more of our major customers;
- ability to identify and integrate Datrix and other acquisitions;
- effects of legislation;
- effects of foreign operations;
- foreign currency risks;
- ability to recruit and retain engineering and technical personnel;

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§ the costs and risks associated with research and development investments;

§ our ability and the ability of our customers to protect intellectual property;

§ loss of members of our senior management team; and

§ our ability to liquidate the assets marked as discontinued operations

For a description of these and other risks, see Risk Factors in Part I, Item 1A: Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2009, and other risks described elsewhere in this Quarterly Report on Form 10-Q, or in other filings the Company makes from time to time with the Securities and Exchange Commission. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

Results of Operations

Sales, net

Consolidated net sales for the three months ended March 31, were as follows (in thousands):

			Change	
	2010	**2009**	**Dollars**	**Percent**
Consolidated net sales	$ 14,553	$ 11,844	$ 2,709	22.9%

Our net sales are comprised of three main markets: hearing health, medical and professional audio device. Below is a summary of our sales by main markets for the three months ended March 31, 2010 and 2009 (in thousands):

			Change	
	2010	**2009**	**Dollars**	**Percent**
Medical	$ 6,508	$ 5,285	$ 1,223	23.1%
Hearing Health	$ 5,370	$ 4,411	$ 959	21.7%
Professional Audio Communications	$ 2,675	$ 2,148	$ 527	24.5%

For the three months ended March 31, 2010, we experienced an increase of 23 percent in net sales in the medical equipment market as a direct result of increased sales to existing OEM customers. Management believes there is an industry-wide trend toward further miniaturization and ambulatory operation enabled by wireless connectivity, referred to as bio-telemetry, which resulted in further growth in our medical business. We have experienced solid growth in our most advanced biotelemetry device, a continuous wireless glucose monitor, which we manufacture for a major medical OEM. We are also working with our strategic partner, AME, on proprietary biotelemetry technologies that will enable us to develop new devices that connect patients and care givers, providing critical information and feedback.In 2009, we also entered the cardiac diagnostic monitoring (CDM) market, with our acquisition of Datrix, a supplier of patient monitoring devices.

Net sales in our hearing health business for the three months ended March 31, 2010 increased 22 percent from the same period in 2009, primarily due to higher demand from our customers and general pickup in the economy. We believe our longer term prospects in our hearing health business remain strong as we continue to develop advanced technologies, such as our nanoDSP , which will enhance the performance of hearing devices. In addition, we believe the market indicators in the hearing health industry, including the aging world population, suggest long-term industry growth.

Net sales to the professional audio device sector increased 25 percent for the three month period ended March 31, 2010 compared to the same period in 2009, primarily due to higher demand from our customers and general pickup in the economy. We believe our extensive portfolio of communication devices that are portable and perform well in noisy or hazardous environments will provide for future long-term growth in this market. These products are well suited for applications in fire, law enforcement, safety, aviation and military markets.

Gross profit

Gross profit, both in dollars and as a percent of sales, for the three months ended March 31, was as follows (in thousands):

	2010		2009		Change	
	Dollars	Percent of Sales	Dollars	Percent of Sales	Dollars	Percent
Gross profit	$ 3,676	25.3%	$ 2,176	18.4%	$ 1,500	68.9%

In 2010, gross profit increased primarily due to higher sales volume and product mix. We have various activities underway to further increase our gross profit, such as transferring our microphone and receiver production from our Maine operation to our lower cost Singapore facility, increasing the percentage of IntriCon proprietary content in the devices we manufacture and working to introduce Six Sigma lean manufacturing methods into key medical device product lines.

Selling, general and administrative expenses

Selling, general and administrative expenses (SG&A) for the three months ended March 31 were as follows (in thousands):

	2010		2009		Change	
	Dollars	Percent of Sales	Dollars	Percent of Sales	Dollars	Percent
Operating expenses:						
Selling	$ 787	$ 3.22	$ 3.18			

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

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EQUUS TOTAL RETURN, INC.

STATEMENTS OF OPERATIONS

	Year Ended December 31,		
(in thousands, except per share amounts)	2018	2017	2016
Investment income:			
Interest and dividend income:			
Non-affiliate investments - related party	$381	$265	$183
Non-affiliate investments	69	285	555
Total interest and dividend income	450	550	738
Interest from temporary cash investments	30	10	10
Total investment income	480	560	748
Expenses:			
Transaction costs	—	2,501	—
Compensation expense	1,731	2,231	1,145
Professional fees	1,254	1,294	1,172
Director fees and expenses	441	531	383
General and administrative expenses	455	397	355
Mailing, printing and other expenses	129	89	114
Taxes	21	20	22
Interest expense	4	11	8
Total expenses before merger termination fee	4,035	7,074	3,199
Merger termination fee (See Note 6)	—	(2,500)	—
Total expenses, net of merger termination fee	4,035	4,574	3,199
Net investment loss	(3,555)	(4,014)	(2,451)
Net realized gain (loss):			
Temporary cash investments	9	(5)	(13)
Net realized gain (loss)	9	(5)	(13)
Net unrealized appreciation (depreciation) of portfolio securities:			
End of period	19,310	14,498	12,262
Beginning of period	14,498	12,262	4,915
Net change in net unrealized appreciation of portfolio securities	4,812	2,236	7,347
Net unrealized depreciation of portfolio securities - related party:			
End of period	(2,251)	(1,036)	(1,990)
Beginning of period	(1,036)	(1,990)	(2,539)
Net change in net unrealized depreciation of portfolio securities - related party	(1,215)	954	549
Net increase (decrease) in net assets resulting from operations	$51	$(829)	$5,432
Net increase (decrease) in net assets resulting from operations per share:			

Basic and diluted	$0.00	$(0.06)	$0.43
Weighted average shares outstanding:			
Basic and diluted	13,518	13,345	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

(in thousands)	Common Stock Number of Shares	Common Stock Par Value	Capital in Excess of Par Value	Undistributed Net Investment Losses	Undistributed Net Capital Gains	Unrealized Appreciation of Portfolio Securities, net	Unrealized Depreciation of Portfolio Securities - Related Party	Total Net Assets
Balances at December 31, 2015	12,674	$ 13	$54,226	$ (19,307)	$ —	$ 4,915	$ (2,539)	$37,308
Net (decrease) increase in net assets resulting from operations	—	—	(13)	(2,451)	—	7,347	549	5,432
Balances at December 31, 2016	12,674	13	54,213	(21,758)		12,262	(1,990)	42,740
Share-based incentive compensation	844	—	1,096	—	—	—	—	1,096
Net (decrease) increase in net assets resulting from operations	—	—	(5)	(4,014)	—	2,236	954	(829)
Balances at December 31, 2017	13,518	13	55,304	(25,772)	—	14,498	(1,036)	43,007
Share-based incentive compensation	—	—	437	—	—	—	—	437
Net (decrease) increase in net assets resulting from operations	—	—	—	(3,555)	9	4,812	(1,215)	51
Balances at December 31, 2018	13,518	$ 13	$55,741	$ (29,327)	$ 9	$ 19,310	$ (2,251)	$43,495

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

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EQUUS TOTAL RETURN, INC.

STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
(in thousands)	2018	2017	2016
Reconciliation of increase (decrease) in net assets resulting from operations to net cash (used in) provided by operating activities:			
Net increase (decrease) in net assets resulting from operations	$51	$(829)	$5,432
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash (used in) provided by operating activities:			
Net realized (gain) loss	(9)	5	13
Net change in unrealized appreciation of portfolio securities	(4,812)	(2,236)	(7,347)
Net change in unrealized depreciation of portfolio securities - related party	1,215	(954)	(549)
Share-based incentive compensation	437	1,096	—
Changes in operating assets and liabilities:			
Purchase of portfolio securities	—	—	(2,000)
Net proceeds from dispositions of portfolio securities	—	2,013	—
(Proceeds from) purchases of temporary cash investments, net	(8,974)	11,991	(15,007)
Decrease in accounts receivable from affiliates	25	25	3
Increase in accrued interest and dividend receivable	(451)	(155)	(660)
(Decrease) increase in other assets	(11)	(33)	6
Increase (decrease) in accounts payable and accrued liabilities	74	(147)	233
Increase (decrease) in accounts payable to related parties	192	(66)	(43)
Net cash (used in) provided by operating activities	(12,263)	10,710	(19,919)
Cash flows from financing activities:			
Borrowings under margin account	74,966	105,942	102,977
Repayments under margin account	(65,983)	(117,938)	(87,983)
Net cash provided by (used in) financing activities	8,983	(11,996)	14,994
Net decrease in cash and cash equivalents	(3,280)	(1,286)	(4,925)
Cash and cash equivalents and restricted cash at beginning of period	10,975	12,261	17,186
Cash and cash equivalents and restricted cash at end of period	$7,695	$10,975	$12,261
Non-cash operating and financing activities:			
Accrued interest or dividends exchanged for portfolio securities	$—	$12	$63
Accrued interest or dividends exchanged for portfolio securities - related party	$303	$265	$313
Supplemental disclosure of cash flow information:			
Interest paid	$3	$12	$7
Income taxes paid	$21	$28	$19

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

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EQUUS TOTAL RETURN, INC.

SELECTED PER SHARE DATA AND RATIOS

	Year ended December 31, 2018	2017	2016	2015	2014
Investment income	$0.04	$0.04	$0.04	$0.03	$0.08
Expenses	0.31	0.34	0.22	0.22	0.28
Net investment loss	(0.27)	(0.30)	(0.19)	(0.19)	(0.20)
Net realized gain (loss)	—	—	—	(0.20)	0.06
Net change in unrealized appreciation (depreciation) of portfolio securities	0.36	0.17	0.58	0.47	0.03
Net change in unrealized depreciation of portfolio securities - related party	(0.09)	0.07	0.04	—	—
Net increase (decrease) in net assets	—	(0.06)	0.43	0.08	(0.11)
Capital transactions:					
Shares issued for portfolio securities	0.04	0.08	—	—	0.37
Dilutive effect of shares issued	—	(0.21)	—	—	(0.54)
Decrease in net assets resulting from capital transactions	0.04	(0.13)	—	—	(0.17)
Net increase (decrease) in net assets	0.04	(0.19)	0.43	0.08	(0.28)
Net assets at beginning of period	3.18	3.37	2.94	2.86	3.14
Net assets at end of period, basic and diluted	$3.22	$3.18	$3.37	$2.94	$2.86
Weighted average number of shares outstanding during period, in thousands	13,518	13,345	12,674	12,674	11,904
Market price per share:					
Beginning of period	$2.40	$2.01	$1.79	$2.10	$1.99
End of period	$1.96	$2.40	$2.01	$1.79	$2.10
Selected information and ratios:					
Ratio of expenses to average net assets	9.33 %	6.52 %	7.99 %	7.61 %	9.75 %
Ratio of net investment loss to average net assets	(8.22 %)	(5.48 %)	(6.12 %)	(6.40 %)	(6.97 %)
Ratio of net increase (decrease) in net assets resulting from operations to average net assets	0.12 %	2.58 %	13.57 %	3.01 %	(3.94 %)
Total return on market price (1)	(18.33 %)	19.40 %	12.29 %	(14.76 %)	5.53 %

(1) Total return = [(ending market price per share + year-to-date dividends paid - beginning market price per share) / beginning market price per share].

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

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EQUUS TOTAL RETURN, INC.

SCHEDULE OF INVESTMENTS

DECEMBER 31, 2018

(in thousands, except share data)

Name and location of Portfolio Company	Industry	Date of Initial Investment	Investment	Principal	Cost of Investment	Fair Value[1]
Control Investments: Majority-owned [3]:						
Equus Energy, LLC Houston, TX	Energy	December 2011	Member interest (100%)		$ 7,050	$ 9,000
Equus Media Development Company, LLC Houston, TX	Media	January 2007	Member interest (100%)		3,000	210
Total Control Investments: Majority-owned (represents 14.9% of total investments at fair value)					$ 10,050	$ 9,210
Affiliate Investments [4]:						
PalletOne, Inc. Bartow, FL	Shipping products and services	October 2001	350,000 shares of common stock (18.7%)		$ 350	$ 20,500
Total Affiliate Investments (represents 33.1% of total investments at fair value)					$ 350	$ 20,500
Non-Affiliate Investments - Related Party (less than 5% owned):						
MVC Capital, Inc. Purchase, NY	Financial services	May 2014	527,138 shares of common stock (1.7%)		$ 6,579	$ 4,328
Total Non-Affiliate Investments - Related Party (represents 7.0% of total investments at fair value)					$ 6,579	$ 4,328
Non-Affiliate Investments (less than 5% owned):						
5TH Element Tracking, LLC Boston, MA	Business products and services	January 2015	14% promissory note due 5/18 [2]	$ 977	$ 977	$ 977
Total Non-Affiliate Investments (represents 1.5% of total investments at fair value)					$ 977	$ 977
Total Investment in Portfolio Securities					$ 17,956	$ 35,015
Temporary Cash Investments						
U.S. Treasury Bill	Government	December 2018	UST 0% 1/19	26,981	$ 26,981	$ 26,981
Total Temporary Cash Investments (represents 43.5% of total investments at fair value)					$ 26,981	$ 26,981

Total Investments	$ 44,937	$ 61,996

(1) See Note 3 to the financial statements, Valuation of Investments.
(2) Non-income-producing.
(3) Majority owned investments are generally defined under the 1940 Act as companies in which we own more than 50% of the voting securities of the company.
(4) Affiliate investments are generally defined under the 1940 Act 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.

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EQUUS TOTAL RETURN, INC.

SCHEDULE OF INVESTMENTS – (Continued)

DECEMBER 31, 2018

(in thousands, except share data)

Except for our holding of shares of MVC (“MVC”), substantially all of our portfolio securities are restricted from public sale without prior registration under the Securities Act of 1933 (hereafter, the “Securities Act”) or other relevant regulatory authority. 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.

As a BDC, 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, 2018, we had invested 87.5% of our assets in securities of portfolio companies that constituted qualifying investments under the 1940 Act. As of December 31, 2018, 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 84.6% of the total value of the investments in portfolio securities as of December 31, 2018.

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 and was 47.1% of our net asset value, 28.9% of our total assets and 58.5% of our investments in portfolio company securities (at fair value) as of December 31, 2018. The value of one segment called “Energy” includes one portfolio company and was 20.7% of our net asset value, 12.7% of our total assets and 25.7% of our investments in portfolio company securities (at fair value) as of December 31, 2018. 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.

Our investments in portfolio securities consist of the following types of securities as of December 31, 2018 (in thousands):

Type of Securities	Cost	Fair Value	Fair Value as

			Percentage of **Net Assets**
Common stock	$6,929	$24,828	57.1 %
Limited liability company investments	10,050	9,210	21.2 %
Secured and subordinated debt	977	977	2.2 %
Total	$17,956	$35,015	80.5 %

The following is a summary by industry of the Fund’s investments in portfolio securities as of December 31, 2018 (in thousands):

Industry	Fair Value	Fair Value as Percentage of **Net Assets**
Shipping products and services	$20,500	47.1 %
Energy	9,000	20.7 %
Financial services	4,328	9.9 %
Business products and services	977	2.2 %
Media	210	0.6 %
Total	$35,015	80.5 %

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

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EQUUS TOTAL RETURN, INC.

SCHEDULE OF INVESTMENTS

DECEMBER 31, 2017

(in thousands, except share data)

Name and Location of Portfolio Company	**Industry**	**Date of Initial Investment**	**Investment**	**Principal**	**Cost of Investment**	**Fair Value[1]**
Control Investments: Majority-owned [3]:						
Equus Energy, LLC Houston, TX	Energy	December 2011	Member interest (100%)		$ 7,050	$ 8,000
Equus Media Development Company, LLC Houston, TX	Media	January 2007	Member interest (100%)		3,000	21
Total Control Investments: Majority-owned (represents 16.7% of total investments at fair value)					**$ 10,050**	**$ 8,212**
Affiliate Investments [4]:						
PalletOne, Inc. Bartow, FL	Shipping products and services	October 2001	350,000 shares of common stock (18.7%)		$ 350	$ 16,686
Total Affiliate Investments (represents 34.0% of total investments at fair value)					**$ 350**	**$ 16,686**
Non-Affiliate Investments - Related Party (less than 5% owned):						
MVC Capital, Inc. Purchase, NY	Financial services	May 2014	496,208 shares of common stock (1.7%)		$ 6,276	$ 5,240
Total Non-Affiliate Investments - Related Party (represents 10.7% of total investments at fair value)					**$ 6,276**	**$ 5,240**
Non-Affiliate Investments (less than 5% owned):						
5TH Element Tracking, LLC Boston, MA	Business products and services	January 2015	14% promissory note due 3/18 [2]	$ 977	$ 977	$ 977
Total Non-Affiliate Investments (represents 2.0% of total investments at fair value)					$ **977**	$ **977**
Total Investment in Portfolio Securities					$ **17,653**	$ **31,115**
Temporary Cash Investments						
U.S. Treasury Bill	Government	December 2017	UST 0% 1/18	$ 17,998	$ 17,998	$ 17,998
					$ 17,998	**$ 17,998**

Total Temporary Cash Investments (represents 36.6% of total investments at fair value)		
Total Investments	**$ 35,651**	**$ 49,113**

(1) See Note 3 to the financial statements, Valuation of Investments.
(2) Income-producing.
(3) Majority owned investments are generally defined under the 1940 Act as companies in which we own more than 50% of the voting securities of the company.
(4) Affiliate investments are generally defined under the 1940 Act 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.

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EQUUS TOTAL RETURN, INC.

SCHEDULE OF INVESTMENTS – (Continued)

DECEMBER 31, 2017

(in thousands, except share data)

Except for our holding of shares of MVC, substantially all of our portfolio securities are restricted from public sale without prior registration under the Securities Act or other relevant regulatory authority. 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.

As a BDC, 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, 2017, we had invested 83.2% of our assets in securities of portfolio companies that constituted qualifying investments under the 1940 Act. As of December 31, 2017, 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 80.0% of the total value of the investments in portfolio securities as of December 31, 2017.

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 and was 38.9% of our net asset value, 27.3% of our total assets and 53.6% of our investments in portfolio company securities (at fair value) as of December 31, 2017. The value of one segment called “Energy” includes one portfolio company and was 18.6% of our net asset value, 13.1% of our total assets and 25.7% of our investments in portfolio company securities (at fair value) as of December 31, 2017. 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.

Our investments in portfolio securities consist of the following types of securities as of December 31, 2017 (in thousands):

Type of Securities	**Cost**	**Fair Value**	**Fair Value as**

			Percentage of Net Assets	
Common stock	$6,626	$21,926	51.0	%
Limited liability company investments	10,050	8,212	19.1	%
Secured and subordinated debt	977	977	2.3	%
Total	$17,653	$31,115	72.4	%

The following is a summary by industry of the Fund's investments in portfolio securities as of December 31, 2017 (in thousands):

Industry	**Fair Value**	**Fair Value as Percentage of Net Assets**	
Shipping products and services	$16,686	38.9	%
Energy	8,000	18.6	%
Financial services	5,240	12.1	%
Business products and services	977	2.3	%
Media	212	0.5	%
Total	$31,115	72.4	%

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

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EQUUS TOTAL RETURN, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018, 2017 AND 2016

(1) ORGANIZATION AND BUSINESS PURPOSE

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 NYSE 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 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 subordinated debt, debt convertible into common or preferred stock, or debt combined with warrants and common and preferred stock. Debt and preferred equity financing may also be used to create long-term capital appreciation through the exercise and sale of warrants received in connection with the financing. We seek to achieve capital appreciation by making investments in equity and equity-oriented securities issued by privately-owned companies in transactions negotiated directly with such companies. Given market conditions over the past several years and the performance of our portfolio, our Management and Board of Directors believe it prudent to continue to review alternatives to refine and further clarify the current strategies.

We elected to be treated as a BDC under the 1940 Act, although our shareholders have authorized us to withdraw this election during 2019 and have done so previously in our efforts to achieve a transformational Consolidation (see "*Significant Developments – Authorization to Withdraw BDC Election*" above). 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.

(2) LIQUIDITY AND FINANCING ARRANGEMENTS

As of December 31, 2018, we had cash and cash equivalents of $7.4 million. We had $35.0 million of our net assets of $43.5 million invested in portfolio securities. We also had $27.3 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, $27.0 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 January 2, 2019 and we subsequently repaid this margin loan. The margin interest was paid on February 5, 2019.

As of December 31, 2017, we had cash and cash equivalents of $10.8 million. We had $31.1 million of our net assets of $43.0 million invested in portfolio securities. We also had $18.2 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, $18.0 million was invested in U.S. Treasury bills and $0.2 million represented a required 1% brokerage margin deposit. These securities were held by a securities brokerage firm and pledged along with other assets to secure repayment of the margin loan. The U.S. Treasury bills matured January 4, 2018 and we subsequently repaid this margin loan. The margin interest was paid on February 5, 2018.

During 2018 and 2017, we 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 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. If we continue to be a BDC, failure to continue to qualify as a RIC could be material to us and our stockholders.

(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—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;

2. With respect to investments with a fair value exceeding $2.5 million that have been held for more than one year, we engage independent valuation firms to assist our investment professionals. These independent valuation firms conduct independent valuations and make their own independent assessments;

3. Our Management produces a report that summarized each of our portfolio investments and recommends a fair value of each such investment as of the date of the report;

4. The Audit Committee of our Board reviews and discusses the preliminary valuation of our portfolio investments as recommended by Management in their report and any reports or recommendations of the independent valuation firms, and then approves and recommends the fair values of our investments so determined to our Board for final approval; and

5. The Board discusses valuations and determines the fair value of each portfolio investment in good faith based on the input of our Management, the respective independent valuation firm, as applicable, and the Audit Committee.

During the first twelve months after an investment is made, we rely on the original investment amount to determine the fair value unless significant developments have occurred during this twelve month period which would indicate a material effect on the portfolio company (such as results of operations or changes in general market conditions).

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.

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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. Also, any failure by a portfolio company to achieve its business plan or obtain and maintain its financing arrangements could result in increased volatility and result in a significant and rapid change in its value.

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

We 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.

Fair Value Measurement—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 as assumptions market participants would use in pricing an asset or liability. The three levels of the fair value hierarchy 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.

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.

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.

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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 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, our valuation process as described above.

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 years ended December 31, 2018 and 2017.

As of December 31, 2018, 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 Measurements as of December 31, 2018		
(in thousands)	Total	Quoted Prices in Active Markets for Identical	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

		Assets (Level 1)		
Assets				
Investments:				
Control investments	$9,210	$—	$—	$9,210
Affiliate investments	20,500	—	—	20,500
Non-affiliate investments - related party	4,328	4,328	—	—
Non-affiliate investments	977	—	—	977
Total investments	35,015	4,328	—	30,687
Temporary cash investments	26,981	26,981	—	—
Total investments and temporary cash investments	$61,996	$31,309	$—	$30,687

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As of December 31, 2017, investments measured at fair value on a recurring basis are categorized in the tables below based on the lowest level of significant input to the valuations:

(in thousands)	Total	Fair Value Measurements as of December 31, 2017 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Investments:				
Control investments	$8,212	$—	$—	$8,212
Affiliate investments	16,686	—	—	16,686
Non-affiliate investments - related party	5,240	5,240	—	—
Non-affiliate investments	977	—	—	977
Total investments	31,115	5,240	—	25,875
Temporary cash investments	17,998	17,998	—	—
Total investments and temporary cash investments	$49,113	$23,238	$—	$25,875

The following table provides a reconciliation of fair value changes during 2018 for all investments for which we determine fair value using significant unobservable (Level 3) inputs:

(in thousands)	Fair value measurements using significant unobservable inputs (Level 3) Control Investments	Affiliate Investments	Non-affiliate Investments	Total
Fair value as of December 31, 2017	$8,212	$ 16,686	$ 977	$25,875
Change in unrealized appreciation	998	3,814	—	4,812
Fair value as of December 31, 2018	$9,210	$ 20,500	$ 977	$30,687

The following table provides a reconciliation of fair value changes during 2017 for all investments for which we determine fair value using significant unobservable (Level 3) inputs:

(in thousands)	Fair value measurements using significant unobservable inputs (Level 3)			
	Control Investments	Affiliate Investments	Non-affiliate Investments	Total
Fair value as of December 31, 2016	$6,462	$ 16,200	$ 2,978	$25,640
Change in unrealized appreciation	1,749	486	—	2,235
Purchases of portfolio securities	—	—	12	12
Proceeds from sales/dispositions	—	—	(2,013)	(2,013)
Fair value as of December 31, 2017	$8,212	$ 16,686	$ 977	$25,875

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.

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Fair value measurements can be sensitive to changes in one or more of the valuation inputs. Changes in discount rates, EBITDA or EBITDA multiples (or revenue or revenue multiples), each in isolation, may change the fair value of certain of our investments. Generally, an increase/(decrease) in market yields, discount rates, or an increase/(decrease) in EBITDA or EBITDA multiples (or revenue or revenue multiples) may result in a corresponding increase/(decrease), respectively, in the fair value of certain of our investments.

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, 2018:

(in thousands)	Fair Value	Valuation Techniques	Unobservable Inputs	Range Minimum	Maximum
Secured and subordinated debt	$977	Yield analysis	Discount for lack of marketability	0 %	0 %
Common stock	20,500	Income/Market approach	EBITDA Multiple/Discount for lack of marketability/Control premium	10%	32.5 %
Limited liability company investments	9,210	Asset approach Discounted cash flow; Guideline transaction method	Recovery rate Reserve adjustment factors	75%	100 %
	$30,687				

Because of the inherent uncertainty of the valuation of portfolio securities which do not have readily ascertainable market values, amounting to $30.7 million and $25.9 million as of December 31, 2018 and 2017, respectively, our fair value determinations may materially differ from the values that would have been used had a ready market existed for the securities.

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*.

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.

Interest and Dividend 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. Dividend income is recorded as dividends are declared by the portfolio company or at the point an obligation exists for the portfolio company to make a distribution.

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 1940 Act.

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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.

Taxes—We intend to comply with the requirements of the Code necessary to qualify as a RIC 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 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 incorporated 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 $0.02 million, for each of the years ended December 31, 2018, 2017 and 2016.

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 paid $3 thousand in state income tax for the year ended December 31, 2018 and 2017. We did not owe state income tax for the year ended December 31, 2016.

Share-Based Incentive Compensation—On June 13, 2016, our shareholders approved the adoption of our 2016 Equity Incentive Plan ("Incentive Plan"). On January 10, 2017, the SEC issued an order approving the Incentive Plan and certain awards intended to be made thereunder. The Incentive 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 Incentive 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. The Incentive 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 Incentive Plan is 2,434,728 shares. The term of the Incentive Plan will expire on June 13, 2026. On March 17, 2017, we granted awards of restricted stock under the Plan to certain of our directors and executive officers in the aggregate amount of 844,500 shares. The awards are each subject to a vesting requirement over a 3-year period unless the recipient thereof is terminated or removed from their position as a director or executive officer without "cause", or as a result of constructive termination, as such terms are defined in the respective award agreements entered into by each of the recipients and the Fund. As of December 31, 2018, 280,000 shares remain unvested. We account for share-based compensation using the fair value method, as prescribed by ASC 718, Compensation—Stock Compensation. Accordingly, for restricted stock awards, we measure the grant date fair value based upon the market price of our common stock on the date of the grant and amortize the fair value of the awards as share-based compensation expense over the requisite service period, which is generally the vesting term. For the year ended December 31, 2018 and

December 31, 2017, we recorded compensation expense of $0.4 million and $1.1 million, respectively, in connection with these awards. There was no share-based compensation for the year ended December 2016.

(4) RELATED PARTY TRANSACTIONS AND AGREEMENTS

MVC Capital, Inc. – Share Exchange. On May 14, 2014, we announced that the Fund intended to effect a reorganization pursuant to Section 2(a)(33) of the 1940 Act (“Plan of Reorganization”). As a first step to consummating the Plan or 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 BDC 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. During 2018, we received 30,929 additional shares in the form of dividend payments. As of December 31, 2018, we valued our 527,138 MVC shares at $4.3 million, a decrease from $5.2 million at December 31, 2017. The value of our MVC shares was based on MVC’s closing trading price on the NYSE as of such dates. Due to the ownership relationship between the Company and MVC, the investment and amounts due to and from MVC have been identified and disclosed as “related party(ies)” in our Consolidated Financial Statements.

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Agreement to Acquire Portfolio Company of MVC—On April 24, 2017, we entered into a Stock Purchase Agreement and Plan of Merger ("Merger Agreement") with ETR Merger Sub, Inc., a newly-formed wholly-owned subsidiary of Equus, certain shareholders of USG&E, and MVC as a selling shareholder of U.S. Gas & Electric, Inc. ("USG&E") and as representative of the selling USG&E shareholders. On May 30, 2017, USG&E and MVC notified us that they had accepted a proposal from Crius Energy Trust, that was considered by the respective boards of directors of USG&E and MVC to constitute a "Superior Proposal" (as such term is defined in the Merger Agreement) to the terms and conditions of the Merger Agreement, and, accordingly, provided us with a notice of termination pursuant to the Merger Agreement. Further, pursuant to the Merger Agreement, USG&E paid us a termination fee of $2.5 million.

Except as noted below, as compensation for services to the Fund, each Independent Director receives an annual fee of $40,000 paid quarterly in arrears, a fee of $2,000 for each meeting of the Board of Directors or committee thereof attended in person, a fee of $1,000 for participation in each telephonic meeting of the Board or committee thereof, and reimbursement of all out-of-pocket expenses relating to attendance at such meetings. The chair of each of our standing committees (audit, compensation, and nominating and governance) also receives an annual fee of $50,000, payable quarterly in arrears. 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. 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 November 2011, Equus Energy, LLC ("Equus Energy"), 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 of the Fund, is a managing partner and co-founder of Global Energy. For each of the years ended December 31, 2017, and 2016, payments to Global Energy totaled $45,000 and 75,000, respectively. The agreement ended in July 2017.

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 rate of $300 per hour for services rendered. During 2018, 2017 and 2016, we paid Kenneth I. Denos, P.C., a professional corporation owned by Kenneth I. Denos, a director of the Fund, $0.4 million, $0.6 million and $0.4 million, respectively, for services provided to the Fund during these years.

(5) PLAN OF REORGANIZATION

Share Exchange with MVC—On May 14, 2014, we announced that the Fund intended to effect a Plan of Reorganization. As a first step to consummating the Plan of Reorganization, we executed a Share Exchange with MVC, wherein we sold to MVC 2,112,000 newly-issued shares of our common stock in exchange for 395,839 newly-issued shares of MVC. We also announced that, pursuant to the Plan of Reorganization, our intention was for Equus to pursue a Consolidation with MVC or one of its portfolio companies.

Authorization to Withdraw BDC Election—As a consequence of our Plan of Reorganization, on January 21, 2019, holders of a majority of the outstanding common stock of the Fund approved our cessation as a BDC under the 1940 Act and authorized our Board of Directors to cause the Fund's withdrawal of its election to be classified as a BDC, each effective as of a date designated by the Board and our Chief Executive Officer on or before July 31, 2019. Notwithstanding these authorizations to withdraw our BDC election, we will not submit any such withdrawal unless and until we are reasonably confident that such Consolidation will be completed.

Agreement to Acquire U.S. Gas & Electric, Inc.—On April 24, 2017, we entered into the Merger Agreement with ETR Merger Sub, Inc., a newly-formed wholly-owned subsidiary of Equus, certain shareholders of USG&E, and MVC as a selling shareholder of USG&E and as representative of the selling USG&E shareholders. On May 30, 2017, USG&E and MVC notified us that they had accepted a proposal from Crius Energy Trust, that was considered by the respective boards of directors of USG&E and MVC to constitute a "Superior Proposal" (as such term is defined in the Merger Agreement) to the terms and conditions of the Merger Agreement, and, accordingly, provided us with a notice of termination pursuant to the Merger Agreement. Further, pursuant to the Merger Agreement, USG&E paid us a termination fee of $2.5 million.

Intention to Continue to Pursue Consolidation—Notwithstanding the termination of the Merger Agreement with USG&E described above, we intend to pursue a Consolidation and the completion of our Plan of Reorganization with another operating company and withdraw our BDC election as authorized by our stockholders. While we are presently evaluating various opportunities that could enable us to accomplish a Consolidation, we cannot assure you that we will be able to do so within any particular time period or at all. Moreover, we cannot assure you that the terms of any such transaction that would embody a potential Consolidation would be acceptable to us.

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(6) FEDERAL INCOME TAX MATTERS

As a RIC, our tax liability is dependent upon whether an election is made to distribute taxable investment income and capital gains above any statutory requirement. As we have incurred net investment losses and have had no realized gains after taking into account our capital loss carryforwards in 2017, 2016 and 2015, no distributions were required or made.

Our year-end for determining capital gains for purposes of Section 4982 of the Code is October 31.

There are no material book to tax differences for net investment income/losses, realized gains or unrealized appreciation/depreciation. As of December 31, 2018, we had approximately $15.7 million in capital losses that can be carried forward indefinitely. During the year ended December 31, 2018, $7 thousand of pre-Regulated Investment Company Modification Act capital loss carryforwards expired. Pursuant to Statement of Position 93-2, the expired capital loss has reduced additional-paid-in-capital.

Reclassification of returns of capital had no material book to tax differences for the three years ended December 31, 2018 and therefore has no material book to tax differences impacting accumulated earnings.

We believe that any aggregate exposure for uncertain tax positions should not materially impact our financial statements as of December 31, 2018 or December 31, 2017. An uncertain tax position is measured as the largest amount of tax return benefits that does not have a greater than 50% likelihood of being realized upon ultimate settlement. We have not recorded an adjustment to our financial statements related to any uncertain tax positions. We will continue to evaluate our tax positions and recognize any future impact of uncertain tax positions as a charge to income in the applicable period in accordance with promulgated standards.

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

All of the Fund’s federal and state tax returns for 2015 through 2018 remain open to examination. We believe that there are no tax positions taken or expected to be taken that would significantly increase or decrease unrecognized tax benefits within 12 months of the reporting date.

(7) COMMITMENTS AND CONTINGENCIES

Lease Commitments. We had an operating lease for office space that expired in September 2014. Our current office space lease as of December 31, 2016 is month-to-month. Rent expense under the operating lease agreement, inclusive of common area maintenance costs, was $111,000, $109,000 and $89,000 for the years ended December 31, 2018, December 31, 2017 and December 31, 2016, respectively.

Portfolio Companies. As of December 31, 2018 and 2017, 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 the portfolio company to ensure that operations are completed, thereby allowing the portfolio company to generate cash flows to service the debt.

Legal Proceedings–Shareholder Complaint. On November 16, 2016, Samuel Zalmanoff filed a lawsuit against the Fund and members of the Board of Directors in the Court of Chancery in the State of Delaware. The lawsuit was filed in connection with the Fund's 2016 Equity Incentive Plan ("Incentive Plan") which was adopted by the Board of Directors on April 15, 2016, approved by the Equus shareholders on June 13, 2016, and approved, with certain standard exceptions, by the Securities and Exchange Commission on January 10, 2017. Mr. Zalmanoff's complaint, which purports to be on behalf of all non-affiliate Equus shareholders entitled to vote for the Incentive Plan, purports to allege a breach by the Board of Directors of its fiduciary duties of disclosure in connection with the Incentive Plan, and seeks an order from the court: (i) enjoining implementation of the Incentive Plan, (ii) requiring the Fund to revise its disclosures relating to the Incentive Plan, and (iii) for an award of costs, attorneys' fees, and expenses. We believe that this lawsuit, and the allegations included therein, are without merit and intend to continue a vigorous defense against the same. On September 22, 2017, we filed a motion for summary judgment regarding this action, which was granted by the Chancery Court on November 13, 2018. Mr. Zalmanoff appealed the Chancery Court ruling to the Delaware Supreme Court and the matter has been briefed for oral argument and a subsequent decision in the coming months. As such, we have concluded that the likelihood of an unfavorable outcome is neither probable nor remote.

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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.

(8) PORTFOLIO SECURITIES

2018 Portfolio Activity

During the year ended December 31, 2018, we received 30,930 shares of MVC in the form of stock dividend payments.

The following table summarizes significant investment activity during the year ended December 31, 2018 (in thousands):

	Investment Activity				
	New Investments		Existing Investments		
Portfolio Company	Cash	Non-Cash	Follow-On	Dividend	Total
MVC Capital, Inc.	$ —	$ —	$ —	$ 303	$ 303
	$ —	$ —	$ —	$ 303	$ 303

During 2018, we realized net capital gains of $9 thousand due to the disposition of temporary cash investments.

During 2018, we recorded an increase of $3.6 million in net unrealized appreciation, from $13.5 million at December 31, 2017 to $17.1 million at December 31, 2018, in our portfolio securities. Such increase resulted primarily from the following changes:

(i) Decrease in the fair value of our shareholding in MVC of $1.2 million due to a decrease in the MVC share price during 2018, which was partially offset by the receipt of dividend payments in the form of additional shares of MVC;

(ii) Increase in fair value of our shareholding in PalletOne, Inc. (“PalletOne”) of $3.8 million due to an overall improvement in comparable industry sectors, as well as continued revenue increases and promising acquisition and growth prospects;

and

(iii) Increase in the fair value of our holdings in Equus Energy of $1.0 million, principally due to an increase in comparable transactions for mineral leases and a continued increase in short- and long-term prices for crude oil and natural gas.

2017 Portfolio Activity

During the year ended December 31, 2017, we received full payment of our senior secured promissory note (“Note”) issued by Biogenic Reagents, LLC (“Biogenic”), in the amount of $2.4 million in cash, consisting of the original principal amount of the Note, together with approximately $0.4 million in interest as accrued thereon.

During the year ended December 31, 2017, we had investment activity of $0.3 million in three portfolio companies. We received $0.04 million in semi-annual interest and $13 thousand in PIK’d interest in respect of the Biogenic Note. During 2016, we received 20,253 shares of MVC in the form of stock dividend payments. We received $12 thousand in PIK’d interest in respect to our loan to 5^{TH} Element Tracking, LLC (“5^{TH} Element”).

The following table summarizes significant investment activity during the year ended December 31, 2017 (in thousands):

	Investment Activity				
	New Investments		**Existing Investments**		
Portfolio Company	**Cash**	**Non-Cash**	**Follow-On**	**PIK/Dividend**	**Total**
5^{TH} Element Tracking, LLC	$—	$—	$—	$12	$12
MVC Capital, Inc.	—	—	—	265	265
	$—	$—	$—	$277	$277

During 2017, we realized net capital losses of $5 thousand due to the disposition of temporary cash investments.

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Year Ended December 31, 2017

During 2017, we recorded an increase of $3.2 million in net unrealized appreciation, from $10.3 million at December 31, 2016 to $13.5 million at December 31, 2016, in our portfolio securities. Such increase resulted primarily from the following changes:

(i) Increase in the fair value of our shareholding in MVC of $1.0 million due to an increase in the MVC share price during 2017 and the receipt of dividend payments in the form of additional shares of MVC;

(ii) Increase in fair value of our shareholding in PalletOne, Inc. (“PalletOne”) of $0.5 million due to an overall improvement in comparable industry sectors, as well as continued revenue increases and promising acquisition and growth prospects; and

(iii) Increase in the fair value of our holdings in Equus Energy of $1.7 million, principally due to an increase in comparable transactions for mineral leases, a combination of increased production, and a continued increase in short- and long-term prices for crude oil and natural gas.

2016 Portfolio Activity

During the year ended December 31, 2016, we had investment activity of $2.4 million in three portfolio companies. We invested $2.0 million in Biogenic in the form of a senior secured Note, bearing cash and PIK interest at the combined rate of 16% per annum. During 2016, we received $0.04 million in semi-annual interest and $13 thousand in PIK’d interest in respect of our note with 5TH Element. During 2016, we also received 22,863 shares of MVC in the form of dividend payments.

The following table summarizes significant investment activity during the year ended December 31, 2016 (in thousands):

	Investment Activity				
	New Investments		Existing Investments		
Portfolio Company	**Cash**	**Non-Cash**	**Follow-On**	**PIK/Dividend**	**Total**
Biogenic Reagents, LLC	$2,000	$—	$—	$13	$2,013
MVC Capital, Inc.	—	—	—	313	313
5TH Element Tracking, LLC	—	—	—	50	50
	$2,000	$—	$—	$376	$2,376

During 2016, we realized net capital losses of $13 thousand due to the disposition of temporary cash investments.

During 2016, we recorded an increase of $7.9 million in net unrealized appreciation, from $2.4 million at December 31, 2015 to $10.3 million at December 31, 2016, in our portfolio securities. Such increase resulted primarily from the following changes:

(i) Increase in the fair value of our shareholding in MVC of $0.5 million due to an increase in the MVC share price during 2016 and the receipt of dividend payments in the form of additional shares of MVC;

(ii) Increase in fair value of our shareholding in PalletOne of $6.6 million due to continued strong revenue and earnings growth, and an overall improvement in comparable industry sectors;

(iii) Increase in the fair value of our holdings in Equus Energy of $0.8 million, principally due to a combination of an increase in comparable transactions for mineral leases, increased production, and a continued increase short- and long-term prices for crude oil and natural gas.

(9) EQUUS ENERGY, LLC

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 presently consisting of 142 producing and non-producing oil and gas wells. The working interests include associated development rights of approximately 21,520 acres situated on 11 separate properties in Texas and Oklahoma. The working interests range from a *de minimus* amount to 50% of the leasehold that includes these wells.

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The wells are operated by a number of 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, is working with Chevron in 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 (appx. 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.

Below is selected financial information from the audited financial statements of Equus Energy as of December 31, 2018 and 2017, and for the years ended December 31, 2018, 2017 and 2016 (in thousands):

EQUUS ENERGY, LLC and SUBSIDIARY

Unaudited Condensed Consolidated Balance Sheets

	December 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 966	$ 307
Accounts receivable	127	101
Other current assets	34	33
Total current assets	1,127	441
Oil and gas properties	8,014	8,064
Less: accumulated depletion, depreciation and amortization	(7,778)	(7,434)
Net oil and gas properties	236	630
Total assets	$ 1,363	$ 1,071
Liabilities and member's equity		
Current liabilities:		
Accounts payable and other	$ 131	$ 107
Due to affiliate	561	586
Total current liabilities	692	693
Asset retirement obligations	195	190
Total liabilities	887	883

Total member's equity	476	188
Total liabilities and member's equity	$ 1,363	$ 1,071

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EQUUS ENERGY, LLC and SUBSIDIARY

Condensed Consolidated Statements of Operations

	Year Ended December 31		
	2018	2017	2016
Operating revenue	$1,085	$861	$683
Operating expenses			
Direct operating expenses	787	554	632
Gain on sale of oil and gas properties	(619)	—	—
General and administrative	284	278	392
Depletion, depreciation, amortization and accretion	344	295	369
Impairment of oil and gas properties	—	—	265
Total operating expenses	796	1,127	1,658
Income (loss) before income tax expense	289	(266)	(975)
Income tax expense, net	1	—	—
Net income (loss)	$288	$(266)	$(975)

EQUUS ENERGY, LLC and SUBSIDIARY

Condensed Consolidated Statements of Cash Flows

	Year ended December 31,		
	2018	2017	2016
Cash flows from operating activities:			
Net income (loss)	$288	$(266)	$(975)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:			
Depletion, depreciation and amortization	338	289	369
Gain on sale of oil and gas properties	(619)	—	—
Accretion expense	6	6	—
Impairment	—	—	265
Changes in operating assets and liabilities:			
Accounts receivable	(26)	(10)	31
Prepaid expenses and other current assets	(2)	(1)	—
Affiliate payable/receivable	(25)	(25)	—
Accounts payable and other	25	32	(131)
Net cash (used in) provided by operating activities	(15)	25	(441)
Cash flows from investing activities:			

Investment in oil & gas properties	(173)	(9)	(35)
Sale of oil & gas properties	847	—	250
Net cash provided by (used in) investing activities	674	(9)	215
Net increase (decrease) in cash	659	16	(226)
Cash and cash equivalents at beginning of period	307	291	517
Cash and cash equivalents at end of period	$966	$307	$291

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(10) RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Standards Recently Adopted—In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230) — Restricted Cash*. This standard provides guidance on the presentation of restricted cash and restricted cash equivalents in the statement of cash flows. Restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period amounts shown on the statements of cash flows. The amendments of this ASU should be applied using a retrospective transition method and are effective for reporting periods beginning after December 15, 2017, with early adoption permitted. Other than the revised statement of cash flows presentation of restricted cash, the adoption of ASU 2016-18 did not have an impact on our financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation-Stock Compensation (Topic 718) —Improvements to Employee Share-Based Payment Accounting*, which is intended to improve the accounting for share-based payments and affects all organizations that issue share-based payment awards to their employees. ASU 2016-09 primarily simplifies the accounting for and classification of, income taxes related to share-based payment awards, including the impact of income taxes withheld on the classification of awards as equity or liabilities and the classification of income taxes on the statement of cash flows. ASU 2016-09 also permits an entity to elect a forfeiture rate assumption based on the estimated number of awards expected to vest or to account for forfeitures when they occur ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We have adopted ASU 2016-09 as of January 1, 2017. The provisions of ASU 2016-09 should be adopted on a modified retrospective, retrospective or prospective basis, depending on the provision. We recently adopted an incentive plan for our directors and management and issued awards under the plan during the quarter ended March 31, 2017. Our adoption of ASU 2016-09 did not have a material effect on our financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force),* which addresses the diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under ASC 230, Statement of Cash Flows, and other topics. ASU 2016-15 provides guidance on eight specific cash flow issues including the statement of cash flows treatment of beneficial interests in securitized financial transactions as well as the treatment of debt prepayment and extinguishment costs. ASU 2016-15 also provides guidance on the predominance principle to clarify when cash receipts and cash payments should be separated into more than one class of cash flows. ASU 2016-15 is effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. There was no impact on our statements of cash flows.

In December 2016, the FASB issued ASU 2016-19, *Technical Corrections and Improvements,* which makes minor corrections and clarifications that affect a wide variety of topics in the Accounting Standards Codification, including an amendment to ASC Topic 820, Fair Value Measurement, which clarifies the difference between a valuation approach and a valuation technique when applying the guidance of that Topic. The amendment also requires an entity to disclose when there has been a change in either or both a valuation approach and/or a valuation technique. The transition guidance for the ASC Topic 820 amendment must be applied prospectively because it could potentially involve the use of hindsight that includes fair value measurements. The new guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those years. Early application is permitted for any fiscal year or interim period for which the entity's financial statements have not yet been issued. There was no impact on the financial position or financial statement disclosures.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 supersedes the revenue recognition requirements under ASC 605, *Revenue Recognition*, and most industry-specific guidance throughout the Industry Topics of the ASC. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. Under the new guidance, an entity is required to perform the following five steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The new guidance will significantly enhance comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. Additionally, the guidance requires improved disclosures as to the nature, amount, timing and uncertainty of revenue that is recognized.

In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net),* which clarified the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing,* which clarified the implementation guidance regarding performance obligations and licensing arrangements.

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In May 2016, the FASB issued ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606)—Narrow-Scope Improvements and Practical Expedients*, which clarified guidance on assessing collectability, presenting sales tax, measuring noncash consideration, and certain transition matters.

In December 2016, the FASB issued ASU No. 2016-20, *Revenue from Contracts with Customers (Topic 606)—Technical Corrections and Improvements*, which provided disclosure relief, and clarified the scope and application of the new revenue standard and related cost guidance. The new guidance will be effective for the annual reporting period beginning after December 15, 2017, including interim periods within that reporting period. Early adoption would be permitted for annual reporting periods beginning after December 15, 2016. We completed our initial assessment in evaluating the potential impact on our financial statements and based on our initial assessment, determined that our financial instruments are excluded from the scope of ASU 2014-09 and ASC 606. As a result of the scope exception for financial instruments, our management has determined that there was no material changes to the recognition timing and classification of revenues and expenses; additionally, there was no significant impact to pretax income or on financial statement disclosures upon adoption.

Accounting Standards Not Yet Adopted—In February 2016, the FASB issued ASU 2016-02, *Leases,* which requires lessees to recognize on the balance sheet a right of use asset, representing its right to use the underlying asset for the lease term, and a lease liability for all leases with terms greater than 12 months. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing, and uncertainty of cash flows arising from leases. The standard requires the use of a modified retrospective transition approach, which includes a number of optional practical expedients that entities may elect to apply. The new guidance is effective for annual periods beginning after December 15, 2018, and interim periods therein. Early application is permitted. The adoption of ASU 2016-02 will not have an impact on our financial statements as we currently have no operating leases as our principal offices are under a month-to-month lease arrangement for annual periods beginning after December 15, 2018, and interim periods therein. Early application is permitted.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326) —Measurement of Credit Losses on Financial Instruments*, which amends the financial instruments impairment guidance so that an entity is required to measure expected credit losses for financial assets based on historical experience, current conditions and reasonable and supportable forecasts. As such, an entity will use forward-looking information to estimate credit losses. ASU 2016-13 also amends the guidance in FASB ASC Subtopic 325-40,Investments -Other, Beneficial Interests in Securitized Financial Assets, related to the subsequent measurement of accretable yield recognized as interest income over the life of a beneficial interest in securitized financial assets under the effective yield method. ASU 2016-13 effective for public business entities that meet the U.S. GAAP definition of an SEC filer, for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We are currently evaluating the impact of ASU 2016-13 on our financial statements.

On August 28, 2018, the FASB issued ASU 2018-13, which changes the fair value measurement disclosure requirements of ASC 820. The amendments remove certain disclosure requirements and modify certain others. The amendments remove the requirement to disclose (1) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, (2) the policy for timing of transfers between levels, (3) the valuation processes for Level 3 fair value measurements and (4) the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period. Also, (1) in lieu of a rollforward for Level 3 fair value measurements, an entity is required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities, (2) for investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly, and (3) the amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. Early adoption is permitted. We are currently evaluating the impact of ASU 2018-13 on our financial statements.

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(11) SELECTED QUARTERLY DATA

(in thousands, except per share amounts)	Year Ended December 31, 2018 Quarter Ended March 31,	Quarter Ended June 30,	Quarter Ended September 30,	Quarter Ended December 31,	Total
Total investment income	$113	$117	$85	$165	$480
Net investment loss	(991)	(936)	(722)	(906)	(3,555)
Increase in net assets resulting from operations	56	793	2,358	(3,156)	51
Basic and diluted earnings per share (1)	0.00	0.06	0.17	(0.23)	0.00

(in thousands, except per share amounts)	**Year Ended December 31, 2017** Quarter Ended March 31,	Quarter Ended June 30,	Quarter Ended September 30,	Quarter Ended December 31,	Total
Total investment income	$190	$137	$112	$121	$560
Net investment loss	(2,480)	(333)	(441)	(760)	(4,014)
Increase in net assets resulting from operations	(1,802)	87	(121)	1,007	(829)
Basic and diluted earnings per share (1)	(0.14)	0.01	(0.01)	0.08	(0.06)

(in thousands, except per share amounts)	**Year Ended December 31, 2016** Quarter Ended March 31,	Quarter Ended June 30,	Quarter Ended September 30,	Quarter Ended December 31,	Total
Total investment income	$138	$227	$191	$192	$748
Net investment loss	(733)	(452)	(570)	(696)	(2,451)
Increase in net assets resulting from operations	242	2,067	1,889	1,234	5,432
Basic and diluted earnings per share (1)	0.02	0.17	0.16	0.08	0.43

[1] The sum of quarterly per share amount may not equal per share amounts reported for year-to-date periods due to changes in the number of weighted average shares outstanding and the effects of rounding.

(12) SUBSEQUENT EVENTS

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

On January 2, 2019, we sold our holding in $27.0 million in U. S. Treasury Bill and we repaid our year-end margin loan.

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

None.

Item 9A. ***Controls and Procedures***

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

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed pursuant to the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based on the definition of "disclosure controls and procedures" as promulgated under the Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

The Fund, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2018. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Management Report on Internal Control Over Financial Reporting

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

We assessed our internal control over financial reporting as of December 31, 2018, the end of our most recent fiscal year. We based our assessment on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in "Internal Control-Integrated Framework" published in 2013. Our assessment included evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies, and our overall control environment. This assessment is supported by testing and monitoring performed both by a third-party consultant and our accounting department.

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

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

None.

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PART III

Item 10. ***Directors, Executive Officers and Corporate Governance***

Information about our Directors and Executive Officers, our Audit Committee and the Nominating and Corporate Governance Committee, our code of ethics applicable to the principal executive officer and principal financial officer, and Section 16(a) Beneficial Ownership Reporting Compliance is incorporated by reference to our Definitive Proxy Statement for the 2019 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, on or prior to April 30, 2019 (the "2019 Proxy Statement").

We have adopted a code of business conduct and ethics applicable to our directors, officers (including our principal executive officer, principal financial officer and controller) and employees, known as the Code of Business Conduct and Ethics. A copy of the Code of Business Conduct and Ethics is available to any person, without charge, upon request addressed to Equus Total Return, Inc., Attention: Corporate Secretary, 700 Louisiana Street, 48th Floor, Houston, TX 77002. In the event that we amend or waive any of the provisions of the Code of Business Conduct and Ethics applicable to our principal executive officer, principal financial officer, or controller, we intend to disclose the same on its website at www.equuscap.com.

Item 11. ***Executive Compensation***

Information regarding Executive Compensation is incorporated by reference to our 2019 Proxy Statement.

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

Information regarding Security Ownership of Certain Beneficial Owners and Management and Securities Authorized for Issuance under Equity Compensation Plans is incorporated by reference to our 2019 Proxy Statement.

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

Information regarding Certain Relationships and Related Transactions is incorporated by reference to our 2019 Proxy Statement.

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

Information regarding Principal Accountant Fees and Services is incorporated by reference to our 2019 Proxy Statement.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

(a)(1) The following financial statement schedules are filed herewith:

Schedule 12-14 Investments in and Advances to Affiliates 62

Item 16. *Form 10-K Summary*

Not Included.

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SCHEDULE 12-14

EQUUS TOTAL RETURN, INC.

SCHEDULE OF INVESTMENTS IN AND ADVANCES TO AFFILIATES

(in thousands)

Portfolio Company	Investment [a]	Year Ended December 31, 2018 Amount of Interest or Dividend Credited to Income[d]	As of December 31, 2017 Fair Value	Gross Additions[b]	Gross Reductions[c]	A D 20 Fa
Control investments: Majority-owned						
Equus Energy, LLC	Member interest (100%)	$ -	$ 8,000	$ 1,000	$ -	$
Equus Media Development Company, LLC	Member interest (100%)	-	212	-	(2)	
Total Control investments: Majority-owned		-	8,212	1,000	(2)	
Total Control investments		-	8,212	1,000	(2)	
Affiliate Investments						
PalletOne, Inc.	350,000 shares of common stock	-	16,686	3,814	-	
Total Affiliate investments		-	16,686	3,814	-	
Total Investments In and Advances to Affiliates		$ -	$ 24,898	$ 4,814	$ (2)	$

This schedule should be read in conjunction with our Financial Statements, including our *Schedule of Investments* and Notes 3 and 4 to the Financial Statements.

(a)

Common stock, warrants, options and equity interests are generally non-income producing and restricted. In some cases, preferred stock may also be non-income producing. The principal amount for debt and the number of shares of common stock and preferred stock is shown in the Schedule of Portfolio Securities as of December 31, 2018.

(b) Gross additions include increases in investments resulting from new portfolio company investments, paid-in-kind interest or dividends, the amortization of discounts and fees, and the exchange of one or more existing securities for one or more new securities. Gross additions also include net increases in unrealized appreciation or net decreases in unrealized depreciation.

(c) Gross reductions include decreases in investments resulting from principal collections related to investment repayments or sales and the exchange of one or more existing securities for one or more new securities. Gross reductions also include net increases in unrealized depreciation or net decreases in unrealized appreciation.

(d) Represents the total amount of interest or dividends credited to income for the portion of the year an investment was a control investment (more than 25% owned) or an affiliate investment (5% to 25% owned), respectively. All dividend income is non-cash unless otherwise noted.

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(a)(2) Exhibits

3. Articles of Incorporation and by-laws.

(a) Restated Certificate of Incorporation of the Fund, as amended. [Incorporated by reference to Exhibit 3(a) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2007.]

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

(c) Amended and Restated Bylaws of the Fund. [Incorporated by reference to Exhibit 3(b) to Registrant's Current Report on Form 8-K filed on December 16, 2010.]

10. Material Contracts.

(c) 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.]

(d) Form of Indemnification Agreement between the Fund and certain of its directors and officers. [Incorporated by reference to Exhibit 10(d) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2011]

(e) Form of Release Agreement between the Fund and certain of its officers and former officers. [Incorporated by reference to Exhibit 10(h) to Registrant's Annual Report on Form 10-K for the year ended December 31, 2004.]

(f) 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.]

(g) Share Exchange Agreement between the Fund and MVC Capital, Inc., dated May 14, 2014 [Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K filed on May 15, 2014.]

(h) Plan of Reorganization of the Registrant, dated as of May 13, 2014 [Incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K filed on May 15, 2014.]

(i) 2016 Equity Incentive Plan, adopted June 13, 2016 [Incorporated by reference to Exhibit 1 to Registrant's Definitive Proxy Statement filed on May 5, 2016.]

31. **Ru**le 13a-14(a)/15d-14(a) Certifications

(1) Certification by Chief Executive Officer

(2) Certification by Chief Financial Officer

32. Section 1350 Certification

(1) Certification by Chief Executive Officer

(2) Certification by Chief Financial Officer

99. Equus Energy, LLC and Subsidiary

(1) Consolidated Financial Statements of Equus Energy, LLC and Subsidiary as of December 31, 2018 and 2017 and for the years ended December 31, 2018, 2017 and 2016 [Incorporated by reference to Exhibit 99.1 to Registrant’s Current Report on Form 10-K filed on March 29, 2018.]

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

EQUUS TOTAL RETURN, INC.

Date: March 29, 2019 /S/ JOHN A. HARDY
John A. Hardy
Chief Executive Officer

(Principal Executive Officer)

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

Signature	Title	Date
/S/ FRASER ATKINSON **Fraser Atkinson**	Director	March 29, 2019
/S/ KENNETH I. DENOS **Kenneth I. Denos**	Director, Secretary and Chief Compliance Officer	March 29, 2019
/S/ HENRY W. HANKINSON **Henry W. Hankinson**	Director	March 29, 2019
/S/ ROBERT L. KNAUSS **Robert L. Knauss**	Director	March 29, 2019
/S/ JOHN A. HARDY **John A. Hardy**	Director, Chief Executive Officer (Principal Executive Officer)	March 29, 2019
/S/ L'SHERYL D. HUDSON **L'Sheryl D. Hudson**	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 29, 2019

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