

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal period ended December 31, 2000

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

Commission File Number 0-19509

EQUUS II INCORPORATED

(Exact name of registrant as specified in its charter)

DELAWARE

76-0345915

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

2929 Allen Parkway, Suite 2500
HOUSTON, TEXAS

77019

(Zip Code)

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

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

Title of each class

Name of each exchange
on which registered

COMMON STOCK

NEW YORK STOCK EXCHANGE

Securities registered pursuant to Section 12(g) of the Act: None

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

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

Approximate aggregate market value of common stock held by non-affiliates of the registrant: \$46,669,214, computed on the basis of \$9.00 per share, closing price of the common stock on the New York Stock Exchange on February 28, 2001. For purposes of calculating this amount only, all directors and executive officers of the registrant have been treated as affiliates. There were 6,674,577 shares of the registrant's common stock, \$.001 par value, outstanding as of February 28, 2001. The net asset value of a share at December 31, 2000 was \$15.40.

Documents incorporated by reference: Proxy Statement for 2001 Annual Meeting of Stockholders is incorporated by reference in Part III.

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ITEM 1. BUSINESS.

Equus II Incorporated (the "Fund") is a Delaware corporation that seeks to achieve capital appreciation principally by making investments in equity and equity-oriented securities issued by privately-owned companies in transactions negotiated directly with such companies ("Portfolio Companies"). The Fund seeks to invest primarily in companies that intend to acquire other businesses, including through leveraged buyouts. The Fund may also invest in recapitalizations of existing businesses or special situations from time to time. The Fund's investments in Portfolio Companies consist principally of equity securities such as common and preferred stock, but also include other equity-oriented securities such as debt convertible into common or preferred stock or debt combined with warrants, options or other rights to acquire common or preferred stock. Current income is not a significant factor in the selection of investments. The Fund has elected to be treated as a business development company under the Investment Company Act of 1940 (the "Investment Company Act").

The Fund has eight directors. Five of such directors are disinterested individuals (the "Independent Directors") as defined by the Investment Company Act. The directors are responsible for providing overall guidance and supervision of the Fund, approving the valuation of the Fund's investments and performing various duties imposed on directors of a business development company by the Investment Company Act. Among other things, the Independent Directors supervise the management arrangements for the Fund, the custody arrangements with respect to portfolio securities, the selection of independent public accountants, fidelity bonding and any transactions with affiliates.

The Fund has engaged Equus Capital Management Corporation, a Delaware corporation (the "Management Company"), to provide certain investment management and administrative services to the Fund. Subject to the supervision of the directors, the Management Company performs, or arranges for third parties to perform, the management, administrative, certain investment advisory and other services necessary for the operation of the Fund. The Management Company identifies, evaluates, structures, monitors and disposes of the Fund's investments. The Management Company also manages the Fund's cash and short-term, interest-bearing investments and provides the Fund, at the Management Company's expense, with the office space, facilities, equipment and personnel (whose salaries and benefits are paid by the Management Company) necessary to enable the Fund to conduct its business.

The Management Company, its officers and directors and the officers of the Fund are collectively referred to herein as "Management". The Fund's principal office is located at 2929 Allen Parkway, Suite 2500, Houston, Texas 77019-2120, and the telephone number is (713) 529-0900.

INVESTMENT PRACTICES

Substantially all of the net assets of the Fund are invested or committed to be invested in securities of Portfolio Companies. Substantially all amounts not invested in securities of Portfolio Companies are invested in short-term, highly liquid investments consisting of interest-bearing bank accounts, certificates of deposit or other short-term, highly liquid investments providing, in the opinion of the Management Company, appropriate safety of principal.

The Fund's investments in portfolio securities are usually structured in private transactions negotiated directly with the owner or issuer of the securities acquired.

The Fund is concentrating its investment efforts on companies of a type and size that, in management's view, provide opportunities for significant capital appreciation, relative ease of acquisition and disposition, reduced competition for investments and prudent diversification of risk.

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The enterprise value of a Portfolio Company typically ranges from \$15,000,000 to \$75,000,000, at the time of the Fund's initial investment. The Fund's initial investment in a Portfolio Company typically ranges from \$1,500,000 to \$7,500,000, depending on the investment. The balance of the purchase price of a Portfolio Company is supplied by debt financing and other equity investors, if necessary.

The Fund is attempting to reduce certain of the risks inherent in private equity-oriented investments by investing in a portfolio of companies involved in different industries. The Fund has limited its initial investment (whether in the form of equity or debt securities, commitments to purchase securities or debt guaranties) in any Portfolio Company to no more than 15% of the Fund's net assets. However, if a follow-on investment is available or required, as discussed below, the Fund's investment in a particular Portfolio Company may exceed these initial investment limitations. Also, investments in certain Portfolio Companies may be in excess of the Fund's initial investment limitations due to increases in the value of such investments.

The Fund may make investments as a sole investor, with other professional investors or with other persons. The Fund ordinarily will not be the sole investor in a Portfolio Company. Joint equity participants may include management of the Portfolio Company, other business development companies, small business investment companies, other institutional or individual investors or venture capital groups. The investment position of the Fund and its co-investors, if any, in Portfolio Companies will typically involve a substantial, and may constitute a controlling, interest in such companies.

The Fund may borrow funds to make new or follow-on investments, to maintain its pass through tax status, or to pay contingencies and expenses. See "Borrowing" and "Loss of Conduit Tax Treatment" under "Factors that May Affect Future Results, the Market Price of Common Stock, and the Accuracy of Forward Looking Statements."

INVESTMENT CRITERIA

Prospective investments are evaluated by Management based upon criteria that may be modified from time to time. The criteria currently being used by Management in determining whether to make an investment in a prospective Portfolio Company include:

1. The presence or availability of competent management;
2. The existence of a substantial market for the products or services of the company characterized by favorable growth potential, or a substantial market position in a stable industry;
3. The existence of a history of profitable operations or a reasonable expectation that operations can be conducted at a level of profitability acceptable in relation to the proposed investment; and
4. The willingness of the company to permit the Fund and its co-investors, if any, to take a substantial position in the company and have representation on its board of directors, so as to enable the Fund to influence the selection of management and basic policies of the company.

CO-INVESTMENTS

The Fund has coinvested in certain Portfolio Companies with Equus Capital Partners, L.P., a

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Delaware limited partnership and an affiliate of the Fund ("ECP"). The Fund and Management obtained an order from the Securities and Exchange Commission (the "SEC") exempting the Fund from certain prohibitions contained in the Investment Company Act relating to coinvestments by the Fund and ECP. Under the terms of the order, Portfolio Securities purchased by the Fund and ECP were required to meet certain guidelines or be approved in advance by the Independent Directors and were required to satisfy certain conditions established by the SEC.

INVESTMENT OPERATIONS

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

IDENTIFYING INVESTMENTS. Investment opportunities are identified for the Fund by the Management Company and its officers and directors. Investment proposals may, however, come to the Fund from many other sources, and may include unsolicited proposals from the public and referrals from banks, lawyers, accountants and members of the financial community. Subject to the approval of the Board of Directors, the Fund may pay such persons (including affiliates of Management other than directors, officers and employees of the Management Company) finder's fees to the extent permissible under applicable law and consistent with industry practice.

EVALUATING INVESTMENT OPPORTUNITIES. Prior to committing funds to an investment opportunity, due diligence is conducted to assess the prospects and risks of the potential investment. See "Investment Criteria" above.

STRUCTURING INVESTMENTS. Portfolio Company investments typically are negotiated directly with the prospective Portfolio Company or its affiliates. The Management Company structures the terms of a proposed investment, including

the purchase price, the type of security to be purchased and the future involvement of the Fund and affiliates in the Portfolio Company's business (including representation on its board of directors). The Management Company seeks to structure the terms of the investment so as to provide for the capital needs of the Portfolio Company and at the same time maximize the Fund's opportunities for capital appreciation in its investment.

PROVIDING MANAGEMENT ASSISTANCE AND MONITORING OF INVESTMENTS. Successful private equity investments typically require active monitoring of, and significant participation in, major business decisions of Portfolio Companies. In most cases, officers of the Fund serve as members of the boards of directors of Portfolio Companies. Such management assistance is required of a business development company under the Investment Company Act and is intended to enable the Fund to provide guidance and management assistance with respect to such matters as capital structure, budgets, profit goals, diversification strategy, financing requirements, management additions or replacements and development of a public or private market for the securities of the Portfolio Company. In connection with their service as directors of Portfolio Companies, officers and directors of Management may receive and retain directors' fees or reimbursement for expenses incurred, and may participate in incentive stock option plans for non-employee directors, if any. When necessary, the Management Company, on behalf of the Fund, may also assign staff professionals with financial or management expertise to assist Portfolio Company management on specific problems.

CURRENT PORTFOLIO COMPANIES

The following is a description of the Fund's investments in its 27 Portfolio Companies at December 31, 2000.

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A. C. LIQUIDATING CORPORATION

A. C. Liquidating Corporation ("ACL"), Houston, Texas, has disposed of its operating businesses and real estate. ACL intends to liquidate in 2001 and will distribute its remaining cash, if any, to its shareholders as soon as possible. At December 31, 2000, the Fund's investment in ACL consisted of \$188,014 in 10% secured promissory notes, which was recorded at no value. Nolan Lehmann, President of the Fund, serves as a director of ACL.

THE BRADSHAW GROUP

The Bradshaw Group ("TBG"), Dallas, Texas, provides innovative printing solutions primarily for customers in need of high-speed mass printings. TBG maintains a web site at www.bradshawgroup.com. At December 31, 2000, TBG was valued at its cost of \$1,335,001. The Fund's investment consisted of 1,335,000 shares of preferred stock and a warrant to buy 2,229,450 shares of common stock at \$0.01 through May 2008, representing an approximate 22.3% fully-diluted equity interest. Gary L. Forbes, a Vice President of the Fund, serves on TBG's Board of Directors.

CHAMPION WINDOW, INC.

Champion Window, Inc. ("Champion"), Houston, Texas, manufactures and sells aluminum windows for single and multi-family residential purposes, primarily in Houston, San Antonio and Austin, Texas. Champion maintains a web site at www.championwindow.net. At December 31, 2000, the Fund's investment in Champion, valued at \$7,542,500 with a cost of \$3,400,000, consisted of 1,400,000 shares of common stock and 20,000 shares of preferred stock. The Fund's investment in Champion represents a 32.4% fully-diluted equity interest. Mr. Lehmann and Patrick M. Cahill, a Vice President of the Fund, serve as directors of Champion.

CONTAINER ACQUISITION, INC.

Container Acquisition, Inc. ("Container"), Houston, Texas, is a logistics and maintenance services company serving owners of international shipping containers. Container maintains a web site at www.containercare.com. At December 31, 2000, the Fund's investment in Container, valued at \$9,299,300 with a cost of \$7,799,300, consisted of 1,370,000 shares of common stock, 64,283 shares of preferred stock and a warrant, exercisable under certain conditions, to buy 370,588 shares of common stock at \$0.01 per share through June 2003. The Fund's investment in Container represents a 65% fully-diluted equity interest. The Fund has committed to invest up to an additional \$2,000,000 in Container under certain circumstances. Mr. Lehmann and Randall B. Hale, a Vice President of the Fund, serve on Container's Board of Directors.

CRC HOLDINGS, CORP.

CRC Holdings, Corp. ("CRC"), Houston, Texas, was formed to acquire CRC Evans Pipeline International, Inc., which designs, manufactures, and services specialized pipeline construction and automatic welding equipment which it rents and sells worldwide. In July 1999, the Fund sold its interest in CRC to LG&E Energy Corp ("LGE"). The Fund is entitled to additional consideration of up to \$10.3 million pursuant to an earn-out agreement that is based on the performance of CRC over its last two and the next two fiscal years. The remaining earnout

receivable at December 31, 2000, with a cost of \$1,192,114, is valued at zero.

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THE DRILLTEC CORPORATION

The Drilltec Corporation ("Drilltec"), Houston, Texas, provides protection and packaging for premium oil tubular goods, drill pipe and line pipe, and manufactures thread protectors for customers worldwide. Drilltec maintains a web site at www.drilltec.com. At December 31, 2000, the Fund's investment in Drilltec, valued at its cost of \$1,000,000, consisted of a warrant to purchase 10% of the common equity for \$100 through September 2002 and a prime + 9.75% promissory note in the amount of \$1,000,000. The Fund recognized a loss on its investment in the preferred stock and common stock of Drilltec of \$7,645,000 in October 2000. The Fund's investment in Drilltec represents a 70% fully-diluted equity interest. Mr. Forbes and Mr. Cahill serve on Drilltec's Board of Directors.

EQUICOM, INC. (FORMERLY TEXROCK RADIO, INC.)

Equicom, Inc. ("Equicom"), Bryan, Texas, was formed to acquire radio stations in small to medium-sized cities in Texas. At December 31, 2000, Equicom owned and operated 21 radio stations. At December 31, 2000, the Fund's investment in Equicom, valued at \$4,562,250 with a cost of \$9,279,610, consisted of 452,000 shares of common stock, 657,611 shares of preferred stock and \$2,562,250 in a 10% promissory note. The Fund's investment in Equicom represents a 56.4% fully-diluted equity interest at December 31, 2000. The Fund has committed to invest up to an additional \$93,500 in Equicom under certain circumstances. Mr. Hale and Tracy H. Cohen, a Vice President of the Fund, serve on Equicom's Board of Directors.

EQUIPMENT SUPPORT SERVICES, INC.

Equipment Support Services, Inc. ("ESS"), Houston, Texas, was formed to buy various companies in the equipment rental business including Carruth-Doggett Industries, Inc. and CDI Rental Services, Inc., in which the Fund had an investment. At December 31, 2000, the Fund's investment in ESS, valued at \$2,500,000 with a cost of \$3,168,500, consisted of 35,000 shares of common stock, 35,000 shares of preferred stock and \$1,138,000 in an 8% promissory note. The Fund's investment in ESS represents a 3.5% fully diluted equity interest at December 31, 2000.

FS STRATEGIES, INC.

FS Strategies, Inc. ("FSS"), Houston, Texas, was formed to acquire Talent Tree Acquisition Corporation ("Talent Tree", formerly Initial Staffing Service) and EESIS, Inc ("EESIS"). Talent Tree and EESIS maintain web sites at www.talenttree.com and www.eesis.com, respectively. Talent Tree operates a network of over 140 branch offices providing temporary staffing and permanent placement services in 46 market areas in thirty states, including eighteen franchises. EESIS is a web-based human resources solution provider based in Houston. At December 31, 2000, FSS was valued at its cost of \$5,500,000. The Fund's investment consisted of 110,000 shares of common stock. The Fund's investment in FSS represents an approximate 23% fully-diluted equity interest. The Fund has committed to invest up to an additional \$750,000 in FSS under certain circumstances. Mr. Lehmann serves on FSS's Board of Directors.

GCS RE, INC.

GCS RE, Inc. ("GCS"), Houston, Texas, was formed to be a general partner of a real estate partnership, which owns a warehouse that is leased to a former subsidiary of a previously owned portfolio company. At December 31, 2000, the Fund's investment in GCS consisted of 1,000 shares of common stock that was valued at \$600,000, with a cost of \$132,910. The Fund owns 100% of the stock of GCS, and GCS owns 50% of the real estate partnership. Sam P. Douglass, Chairman and CEO of the

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Fund, and Mr. Lehmann serve on the Board of Directors of GCS.

HOT & COOL HOLDINGS, INC.

Hot & Cool Holdings, Inc. ("Hot & Cool"), Laredo, Texas, is a manufacturer and distributor of automotive radiators and other heat transfer products. At December 31, 2000, the Fund's investment in Hot & Cool, valued at zero with a cost of \$5,775,000, consisted of \$1,075,000 in a 9% increasing rate subordinated promissory note, \$2,200,000 in 10% subordinated notes, \$2,500,000 in a 12% senior unsecured promissory note, and warrants to buy up to 14,942 and 10,000 shares of common stock at \$0.01 per share through March 2006 and February 2003, respectively. The Fund's investment represents an approximate 25.8% fully-diluted equity interest in Hot & Cool. Mr. Lehmann serves on Hot & Cool's Board of Directors.

NCI BUILDING SYSTEMS, INC. (NYSE: NCS)

NCI Building Systems, Inc. ("NCS"), Houston, Texas, manufactures and markets metal building systems, components and roll up doors for non-residential users from operating facilities located throughout the U.S. and Mexico. NCS maintains a web site at www.ncilp.com. The December 31, 2000 closing price of NCS's common stock on the New York Stock Exchange was \$18.8125 per share. At December 31, 2000, the Fund's investment in NCS consisted of 200,000 shares of common stock valued at \$3,762,500 with a cost of \$159,784, which represents an approximate 1% fully-diluted equity interest in NCS. Mr. Forbes serves as a director of NCS.

PARACELSUS HEALTHCARE CORPORATION (OTCBB:PLHC)

Paracelsus Healthcare Corporation ("PLHC"), Houston, Texas, owns or operates, directly or through hospital partnerships, ten acute-care hospitals in six states. In September 2000, PLHC filed for protection under Chapter 11 of the Federal Bankruptcy Code. PLHC has negotiated a plan of reorganization with its primary creditors and expects to emerge from bankruptcy in March 2001. The December 31, 2000 closing price of PLHC's common stock on the over the counter bulletin board was \$0.013 per share. At December 31, 2000, the Fund's investment in PLHC, valued at \$22,549 with a cost of \$4,299,449, consisted of 1,844,345 shares of common stock. The common stock of PLHC was valued by the Fund at a discounted average of \$0.01261 per share at December 31, 2000, due to restrictions on the Fund's ability to sell such stock, which resulted in an aggregate reduction in value from the market price on such date of \$1,518. The Fund's investment in PLHC represents an approximate 3% fully-diluted equity interest in PLHC. Mr. Lehmann serves on PLHC's Board of Directors.

PETROCON ENGINEERING, INC.

Petrocon Engineering, Inc. ("Petrocon"), Beaumont, Texas, is an international engineering, systems and construction management firm, servicing industrial customers with a primary focus in the process industries - oil, chemical, petrochemical and forest products. At December 31, 2000, the Fund's investment, valued at its original cost of \$7,323,323, consisted of 887,338 shares of common stock, \$2,659,332 in an 8% Series B junior subordinated promissory note, \$4,663,356 in a 12% promissory note and a warrant to buy 1,552,571 shares of common stock for \$0.01 through March 2009. The Fund's investment in Petrocon represents an approximate 30% fully-diluted interest in Petrocon through March 2009. Mr. Forbes and Ms. Cohen serve on Petrocon's Board of Directors.

RAYTEL MEDICAL CORPORATION (NASDAQ: RTEL)

Raytel Medical Corporation ("RTEL"), San Mateo, California, is a leading nationwide provider

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of alternate-site medical service to physicians, hospitals, patients and managed care groups. The December 31, 2000 closing price of RTEL's common stock on the NASDAQ National Market was \$0.8125 per share. At December 31, 2000, the Fund's investment in RTEL, valued at \$26,872 with a cost of \$330,730, consisted of 33,073 shares of common stock. The Fund's investment in RTEL represents less than a 1% equity interest.

SOVEREIGN BUSINESS FORMS, INC.

Sovereign Business Forms, Inc. ("Sovereign"), Houston, Texas, is a manufacturer of wholesale business forms in six states. At December 31, 2000, the Fund's investment in Sovereign, valued at \$6,026,386 with a cost of \$4,394,844, consisted of 16,011 shares of preferred stock, \$2,793,744 in 15% promissory notes and warrants to buy up to 551,894, 25,070 and 273,450 shares of common stock at \$1, \$1.25 and \$1 per share through August 2006, October 2007 and October 2009, respectively. The Fund has committed to invest up to an additional \$625,000 under certain circumstances. The Fund's investment represents a 31% fully-diluted equity interest in Sovereign. Mr. Forbes serves on Sovereign's Board of Directors.

SPECTRUM MANAGEMENT, LLC

Spectrum Management, LLC ("Spectrum"), Dallas, Texas, was formed to acquire a business which provides security devices to financial institutions. At December 31, 2000, the Fund's investment in Spectrum, valued at its original cost of \$2,850,000, consisted of 285,000 units of Class A equity interests. The Fund's investment in Spectrum represents a 79% fully-diluted equity interest in Spectrum. Mr. Forbes and Mr. Hale serve on the Board of Directors of Spectrum.

STEPHEN L. LAFRANCE HOLDINGS, INC.

Stephen L. LaFrance Holdings, Inc. ("LaFrance"), Pine Bluff, Arkansas, owns and operates 98 retail drug stores primarily in Arkansas, Mississippi and Tennessee. At December 31, 2000, the Fund's investment in LaFrance, valued at \$9,498,452 with a cost of \$2,498,452, consisted of 2,498,452 shares of preferred stock and a warrant to buy 269 shares of common stock at \$0.01 per share through September 2007. The Fund's investment in LaFrance represents an approximate 20% fully-diluted equity interest. Mr. Forbes serves on the Board of Directors of

STERNHILL PARTNERS I, L.P.

Sternhill Partners I, L.P. ("Sternhill"), Houston, Texas, is a venture capital fund which was formed to invest in seed and early stage information, communication and entertainment technology companies. Sternhill maintains a web site at www.sternhillpartners.com. The Fund has committed to invest up to \$3,000,000 in Sternhill. At December 31, 2000, the Fund's investment in Sternhill was valued at \$1,000,000 with a cost of \$900,000. The Fund's investment consisted of a 3% limited partnership interest.

STRATEGIC HOLDINGS, INC. AND RELATED ENTITY

Strategic Holdings, Inc. ("SHI"), Houston, Texas, was formed to acquire Strategic Materials, Inc., formerly known as Allwaste Recycling, Inc., the glass recycling division of Allwaste, Inc. SHI receives and processes used glass, which is then sold to the container, fiberglass and bead industries as a raw material source. At December 31, 2000, the Fund's investment in SHI was valued at \$10,000,000 with an original cost of \$13,659,013. The Fund's investment in SHI consists of 3,089,751 shares of common stock, 3,822,157 shares of Series B preferred stock, \$6,750,000 in a 15% promissory note and

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warrants to buy 225,000, 100,000 and 2,219,237 shares of SHI common stock at \$0.4643, \$1.50 and \$0.01 per share through August 2005, August 2005 and November 2005, respectively. Mr. Lehmann and Mr. Hale serve as directors of SHI.

SMIP, Inc. ("SMIP"), Houston, Texas, was formed to be the general partner of a limited partnership which owns an 18% fully-diluted interest in SHI. Management personnel of Strategic Materials, Inc. are the limited partners of the partnership. At December 31, 2000, the Fund's investment in SMIP was valued at \$175,000, with a cost of \$325,000. The Fund's investment in SMIP consists of 1,000 shares of common stock and \$175,000 in a 15% promissory note. SMIP is wholly-owned by the Fund. Mr. Lehmann and Mr. Hale serve as directors of SMIP.

The Fund's investments in SHI and SMIP represent an approximate 85% fully-diluted equity interest in SHI.

SUMMIT/DPC PARTNERS, L. P.

Summit/DPC Partners, L. P. ("DPC"), Houston, Texas, was formed to invest in Doane Pet Care Enterprises, Inc., which is believed to be the largest manufacturer of private label dry pet food in the United States. At December 31, 2000, the Fund's investment in DPC was valued at \$10,000,000, with an original cost of \$3,326,565. The Fund's investment consists of an approximate 36.11% limited partnership interest in DPC, which in turn owns an approximate 16% fully-diluted interest in Doane Pet Care Enterprises, Inc.

TRAVIS INTERNATIONAL, INC.

Travis International, Inc. ("Travis"), Houston, Texas, distributes specialty products for industrial and commercial use, including o-rings, gaskets and sealants and designs and manufactures various other products used in the concrete construction industry. At December 31, 2000, the Fund's investment in Travis, valued at \$1,500,000 with a cost of \$5,398, consisted of 98,761 shares of common stock, which represents an approximate 6.8% fully-diluted equity interest in Travis. Mr. Lehmann serves as a director of Travis.

TULSA INDUSTRIES, INC.

Tulsa Industries, Inc. ("Tulsa"), Houston, Texas, manufactures equipment for the oil and gas industry. At December 31, 2000, the Fund's investment in Tulsa was valued at \$1,713,769 with an original cost of \$7,213,769. The Fund's investment consisted of 209,089 shares of common stock, 1,058 shares of Series B preferred stock and \$655,769 in a junior participation promissory note, representing an approximate 26.3% fully-diluted equity interest. Mr. Forbes and Mr. Hale serve on Tulsa's Board of Directors.

TURFGRASS AMERICA, INC.

Turfgrass America, Inc. ("Turfgrass"), Granbury, Texas, was formed for the purpose of acquiring all the outstanding stock of C&D Turfgrass, Ltd., Crenshaw & Doguet Turfgrass, Inc., Millberger Turf Farms, Inc., Millberger Turf Sales, Inc., and 5-T Enterprises, Inc. (the parent of Thomas Bros. Grass, Ltd.). The combination of these companies has created one of the largest warm season turfgrass companies in the country. Turfgrass maintains a web site at www.turfgrassamerica.com. At December 31, 2000, the Fund's investment in Turfgrass was valued at its cost of \$4,195,000. The Fund's investment consisted of 3,167,756 shares of common stock and \$3,595,000 invested in a \$4,000,000, 12% subordinated promissory note, representing an approximate 11% fully-diluted equity interest in

Turfgrass. The Fund has committed to invest up to an additional \$1,000,000 under certain circumstances. Mr. Hale serves as a director of Turfgrass.

UNITED INDUSTRIAL SERVICES, INC.

United Industrial Services, Inc. ("UIS"), Houston, Texas, specializes in field services for the petrochemical and power generation industries. At December 31, 2000, the Fund's investment in UIS was valued at \$3,085,100 with an original cost of \$4,085,100 and consisted of \$585,000 in a 15% promissory note, 35,000 shares of preferred stock and warrants to buy up to 63,637 and 18,887 shares of common stock at \$0.01 through June 2008 and March 2011, respectively. The Fund's investment in UIS represents an approximate 38% fully-diluted equity interest. Mr. Forbes serves on UIS's Board of Directors.

VANGUARD VII, L.P.

Vanguard VII, L.P. ("Vanguard"), Houston, Texas, is a venture capital fund which was formed to invest in seed and early stage communications, internet and life science technology companies. Vanguard maintains a web site at www.vanguardventures.com. The Fund has committed to invest up to \$3,000,000 in Vanguard. At December 31, 2000, the investment in Vanguard was valued at its cost of \$600,000. The Fund's investment consisted of a 1.3% limited partnership interest.

TEMPORARY INVESTMENTS

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

FOLLOW-ON INVESTMENTS

Following its initial investment in a Portfolio Company, the Fund may be requested to make follow-on investments in the company. Follow-on investments may be made to take advantage of warrants or other preferential rights granted to the Fund or otherwise to increase the Fund's position in a successful or promising Portfolio Company. The Fund may also be called upon to provide additional equity or loans needed by a Portfolio Company to fully implement its business plans, to develop a new line of business or to recover from unexpected business problems. The Fund may make follow-on investments in Portfolio Companies from funds on hand or may borrow all or a portion of the funds required to make such follow-on investments.

DISPOSITION OF INVESTMENTS

The method and timing of the disposition of the Fund's portfolio investments is critical to the realization of capital appreciation and to the minimization of any capital losses. The Fund expects to

dispose of its portfolio securities through a variety of transactions, including sales of portfolio securities in underwritten public offerings, public sales of such securities and negotiated private sales of such securities to the Portfolio Company itself or to other investors. In addition, the Fund may distribute its portfolio securities in-kind to its shareholders. In structuring investments, the Fund endeavors to reach such agreements or understandings with a prospective Portfolio Company as may be appropriate with respect to the method and timing of the disposition of the Fund's investment and, if appropriate, seeks to obtain registration rights at the expense of the Portfolio Company. The Fund bears the costs of disposing of investments to the extent not paid by the Portfolio Company.

OPERATING EXPENSES

The Management Company, at its expense, provides the Fund with office space, facilities, equipment and personnel (whose salaries and benefits are paid by the Management Company) necessary for the conduct of the Fund's business and pays all costs related to proposed acquisitions of portfolio securities that are not completed, unless such proposed acquisitions have been previously approved by the Board of Directors of the Fund.

The Fund is responsible for paying certain expenses relating to its operations, including: management fees to the Management Company; fees and

expenses of the Independent Directors; finder's fees; direct costs of proposed investments in Portfolio Companies, whether or not completed, if such proposed investments have been approved for acquisition by the Board of Directors of the Fund; depositary fees of unaffiliated depositaries; fees of unaffiliated transfer agents, registrars and disbursing agents; the administrative fee to the Management Company; portfolio transaction expenses; interest; legal and accounting expenses; costs of printing and mailing proxy materials and reports to shareholders; New York Stock Exchange fees; custodian fees; litigation costs; costs of disposing of investments including brokerage fees and commissions; and other extraordinary or nonrecurring expenses and other expenses properly payable by the Fund. The Fund has the ability to pay bonuses to its officers, however to date the Fund has not paid any bonuses.

VALUATION

On a quarterly basis, the Management Company performs a valuation of the investments in portfolio securities of the Fund, subject to the approval of the Board of Directors of the Fund. Valuations of portfolio securities are done in accordance with generally accepted accounting principles and the financial reporting policies of the SEC. The applicable methods prescribed by such principles and policies are described below.

The fair value of investments for which no market exists (including most investments made by the Fund) is determined on the basis of procedures established in good faith by the Board of Directors of the Fund. As a general principle, the current "fair value" of an investment being valued by the directors would be the amount the Fund might reasonably expect to receive for it upon its current sale. There is a range of values that are reasonable for such investments at any particular time. Generally, cost is the primary factor used to determine fair value until significant developments affecting the Portfolio Company (such as results of operations or changes in general market conditions) provide a basis for use of an appraisal valuation.

Appraisal valuations are based upon such factors as the Portfolio Company's earnings, cash flow and net worth, the market prices for similar securities of comparable companies and an assessment of the company's future financial prospects. In the case of unsuccessful operations, the appraisal may be based upon liquidation value. Appraisal valuations are necessarily subjective.

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The Fund may also use, when available, third-party transactions in a Portfolio Company's securities as the basis of valuation (the "private market method"). The private market method will be used only with respect to completed transactions or firm offers made by sophisticated, independent investors. Securities with legal, contractual or practical restrictions on transfer may be valued at a discount from their value determined by the foregoing method to reflect such restrictions.

Fund investments for which market quotations are readily available and which are freely transferable are valued as follows: (i) securities traded on a securities exchange or the NASDAQ National Market are valued at the closing price on the date of valuation and (ii) securities traded in the over-the-counter market are valued at the average of the closing bid and asked prices on the date of valuation. For securities which are in a class of public securities but are restricted from free trading (such as Rule 144 stock), valuation is set by discounting the closing sales or bid price to reflect the estimated effects of the illiquidity caused by such restrictions. The fair values of debt securities, which are generally held to maturity, are determined on the basis of the terms of the debt securities and the financial condition of the issuer. Certificates of deposit purchased by the Fund generally will be valued at their face value, plus interest accrued to the date of valuation.

The directors review the valuation policies on a quarterly basis to determine their appropriateness and may also hire independent firms to review the Management Company's methodology of valuation or to conduct an independent valuation.

On a daily basis, the Fund adjusts its net asset value for the changes in the value of its publicly held securities and material changes in the value of its private securities and reports those amounts to Lipper Analytical Services, Inc. Weekly and daily net asset values appear in various publications, including BARRON'S and THE WALL STREET JOURNAL and on the Fund's website at www.equuscap.com.

CUSTODIAN

The Fund acts as the custodian of its securities to the extent permitted under the Investment Company Act and is subject to the restrictions imposed on self-custodians by the Investment Company Act and the rules and regulations thereunder. The Fund has entered into an agreement with Bank of America, N.A. with respect to the safekeeping of such securities. The principal business office of the custodian is 700 Louisiana Street, 6th Floor, Houston, Texas 77002.

The Fund employs American Stock Transfer & Trust Company as its transfer agent to record transfers of the shares, maintain proxy records and to process distributions. The principal business office of such company is 40 Wall Street, New York, NY, 10005.

FACTORS THAT MAY AFFECT FUTURE RESULTS, THE MARKET PRICE OF COMMON STOCK, AND THE ACCURACY OF FORWARD-LOOKING STATEMENTS

In the normal course of its business, the Fund, in an effort to keep its stockholders and the public informed about the Fund's operations and portfolio of investments, may from time-to-time issue certain statements, either in writing or orally, that contain or may contain forward-looking information. Generally, these statements relate to business plans or strategies of the Fund or Portfolio Companies in which it invests, projected or anticipated benefits or consequences of such plans or strategies, projected or anticipated benefits of new or follow-on investments made by or to be made by the Fund, or projections involving anticipated purchases or sales of securities or other aspects of the Fund's operating results. Forward-looking statements are not guarantees of future performance and are subject to risks and

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uncertainties that could cause actual results to differ materially. As noted elsewhere in this report, the Fund's operations and portfolio of investments are subject to a number of uncertainties, risks, and other influences, many of which are outside the control of the Fund, and any one of which, or a combination of which, could materially affect the results of the Fund's operations or net asset value, the market price of its common stock, and whether forward-looking statements made by the Fund ultimately prove to be accurate.

The following discussion outlines certain factors that in the future could affect the Fund's results for 2001 and beyond and cause them to differ materially from those that may be set forth in any forward-looking statement made by or on behalf of the Fund:

LONG-TERM OBJECTIVE. The Fund is intended for investors seeking long-term capital growth. The Fund is not meant to provide a vehicle for those who wish to play short-term swings in the stock market. The portfolio securities acquired by the Fund generally require four to seven years to reach maturity and generally are illiquid. An investment in shares of the Fund should not be considered a complete investment program. Each prospective purchaser should take into account his investment objectives as well as his other investments when considering the purchase of shares of the Fund.

NON-DIVERSIFIED STATUS; NUMBER OF INVESTMENTS. The Fund is classified as a "non-diversified" investment company under the Investment Company Act, which means the Fund is not limited in the proportion of its assets that may be invested in the securities of a single issuer. Generally, the Fund does not intend to initially invest more than 15% of the value of its net assets in a single portfolio company. However, follow-on investments or a disproportionate increase in the value of one portfolio company may result in greater than 15% of the Fund's net assets being invested in a single portfolio company. While these restrictions limit the exposure of the capital of the Fund in any single investment, to the extent the Fund takes large positions in the securities of a small number of issuers, the Fund will be exposed to a greater risk of loss and the Fund's net asset value and the market price of its common stock may fluctuate as a result of changes in the financial condition, the stock price of, or in the market's assessment of any single Portfolio Company to a greater extent than would be the case if it were a "diversified" company holding numerous investments. The Fund currently has investments in 27 Portfolio Companies, of which none exceed 15% of the value of its net assets and four of the remaining investments exceed 10%.

LEVERAGED PORTFOLIO INVESTMENTS. While leveraged buyout investments and investments in highly leveraged companies offer the opportunity for significant capital gains and current income, such investments involve a high degree of business and financial risk and can result in substantial losses. The Fund's Portfolio Companies incur substantial indebtedness in connection with leveraged buyout or other highly leveraged transactions. Such indebtedness generally represents from 66% to 90% of the capitalization of a Portfolio Company. In the event a Portfolio Company cannot generate adequate cash flow to meet the principal and interest payments on such indebtedness, the Fund's equity investment could be reduced or eliminated through foreclosure on the Portfolio Company's assets or the Portfolio Company's reorganization or bankruptcy. A substantial portion of the indebtedness incurred by Portfolio Companies may bear interest at rates that will fluctuate in accordance with a stated interest rate index or the prime lending rate. The cash flow of a Portfolio Company may not be sufficient to meet increases in interest payments on its indebtedness. Accordingly, the profitability of the Fund's Portfolio Companies, as well as appreciation of the investments in such companies, will depend in a significant part upon prevailing interest rates.

LACK OF LIQUIDITY OF PORTFOLIO INVESTMENTS. The portfolio investments of the Fund consist principally of securities that are subject to restrictions on

sale because they were acquired from the issuer in "private placement" transactions or because the Fund is deemed to be an affiliate of the issuer. Generally,

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the Fund will not be able to sell these securities publicly without the expense and time required to register the securities under the Securities Act and applicable state securities law unless an exemption from such registration requirements is available. In addition, contractual or practical limitations may restrict the Fund's ability to liquidate its securities in Portfolio Companies since in many cases the securities of such companies will be privately held and the Fund may own a relatively large percentage of the issuer's outstanding securities. Sales may also be limited by securities market conditions, which may be unfavorable for sales of securities of particular issuers or issuers in particular industries. The above limitations on liquidity of the Fund's securities could preclude or delay any disposition of such securities or reduce the amount of proceeds that might otherwise be realized.

NEED FOR FOLLOW-ON INVESTMENTS IN PORTFOLIO COMPANIES. After its initial investment in a Portfolio Company, the Fund may be called upon from time to time to provide additional funds to such company or have the opportunity to increase its investment in a successful situation, e.g., the exercise of a warrant to purchase common stock. There is no assurance that the Fund will make, or have sufficient funds to make, follow-on investments. Any decision by the Fund not to make a follow-on investment or any inability on its part to make such an investment may have a negative impact on a Portfolio Company in need of such an investment or may result in a missed opportunity for the Fund to increase its participation in a successful operation and may dilute the Fund's equity interest in or reduce the expected yield on its investment.

COMPETITION FOR INVESTMENTS. The Fund encounters competition from other persons or entities with similar investment objectives. These competitors include leveraged buyout partnerships, other business development companies, investment partnerships and corporations, small business investment companies, large industrial and financial companies investing directly or through affiliates, foreign investors of various types and individuals. Many of these competitors have greater financial resources and more personnel than the Fund and may be subject to different and frequently less stringent regulation.

BORROWING. The Fund may borrow funds to make new or follow-on investments, to maintain its pass-through tax status as a regulated investment company under Subchapter M of the Code or to pay contingencies and expenses. The Fund is permitted under the Investment Company Act to borrow funds if, immediately after the borrowing, it will have an asset coverage of at least 200%. That is, the Fund may borrow funds in an amount up to 50% of the value of its assets (including investments made with borrowed funds). The amount and nature of any Fund borrowings will depend upon a number of factors over which the Fund has no control, including general economic conditions, conditions in the financial markets and the impact of the financing on the tax treatment of the stockholders. The use of leverage, even on a short-term basis, could have the effect of magnifying increases or decreases in the Fund's net asset value. While the "spread" between the current yield on the Fund's investments and the cost of any loan would augment the stockholders' return from the Fund, if the spread narrows (because of an increase in the cost of debt or insufficient income on the Fund's investments), distributions to the stockholders would be adversely affected. If the spread were reversed, the Fund might be unable to meet its obligations to its lenders, which might then seek to cause the Fund to liquidate some or all of its investments. There can be no assurance that the Fund would realize full value for its investments or recoup all of its capital if its portfolio investments were involuntarily liquidated.

The costs of borrowing money may exceed the income from the portfolio securities purchased by the Fund with the borrowed money. The Fund will suffer a decline in net asset value if the investment performance of the additional securities purchased with borrowed money fails to cover their cost to the Fund (including any interest paid on the money borrowed). A decline in net asset value could affect the ability of the Fund to make distributions on its common stock. Failure by the Fund to distribute a sufficient portion of its net investment income and net realized capital gains could result in a loss of pass-

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through tax status or subject the Fund to a 4% excise tax. See "Tax Matters." If the asset coverage for debt securities issued by the Fund declines to less than 200% (as a result of market fluctuations or otherwise), the Fund may be required to sell a portion of its investments when it may be disadvantageous to do so.

Because of the nature and size of its portfolio investments, the Fund borrows money from time to time to make qualifying investments to maintain its tax status under the Code. There can be no assurance that debt financing will be available on terms that the Fund considers to be acceptable and in the best interests of the Fund. If borrowing is unavailable, the Fund may be required to make an untimely disposition of an investment or lose its pass-through tax status. See "Loss of Conduit Tax Treatment" below.

LOSS OF CONDUIT TAX TREATMENT. The Fund may cease to qualify for conduit tax treatment if it is unable to comply with the diversification requirements contained in Subchapter M of the Internal Revenue Code. Subchapter M requires that at the end of each quarter (i) at least 50% of the value of the Fund's assets must consist of cash, government securities and other securities of any one issuer that do not represent more than 5% of the value of the Fund's total assets and 10% of the outstanding voting securities of such issuer, and (ii) no more than 25% of the value of the Fund's assets may be invested in the securities of any one issuer (other than United States government securities), or of two or more issuers that are controlled by the Fund and are engaged in the same or similar or related trades or businesses. The Fund will borrow funds if necessary to make qualifying investments to satisfy the foregoing diversification requirements. If the Fund fails to satisfy such diversification requirements and ceases to qualify for conduit tax treatment, the Fund will be subject to income tax on its income and gains and stockholders will be subject to income tax on distributions. The Fund may also cease to qualify for conduit tax treatment, or be subject to a 4% excise tax, if it fails to distribute a sufficient portion of its net investment income and net realized capital gains.

MARKET VALUE AND NET ASSET VALUE. The shares of the Fund's common stock are listed on the NYSE. Investors desiring liquidity may trade their shares of Common Stock on the NYSE at current market value, which may differ from the then current net asset value. Shares of closed-end investment companies frequently trade at a discount from net asset value. This characteristic of shares of a closed-end fund is a risk separate and distinct from the risk that the Fund's net asset value will decrease. The risk of purchasing shares of a closed-end fund that might trade at a discount is more pronounced for investors who wish to sell their shares in a relatively short period of time because for those investors, realization of a gain or loss on their investments is likely to be more dependent upon the existence of a premium or discount than upon portfolio performance. The Fund's shares have traded at a discount to net asset value since they began trading. For information concerning the trading history of the Fund's shares see "Market for Registrant's Common Stock and Related Stockholder Matters."

VALUATION OF INVESTMENTS. The Fund's net asset value is based on the value assigned to its portfolio investments. Investments in companies whose securities are publicly traded are valued at their quoted market price, less a discount to reflect the estimated effects of restrictions on the sale of such securities, if applicable. The Fund adjusts its net asset value for changes in the value of its publicly held securities on a daily basis. The value of the Fund's investments in securities for which market quotations are not available is determined as of the end of each calendar quarter, unless there is a significant event requiring a change in valuation in the interim. Cost is used to approximate fair value of such investments until significant developments affecting an investment provide a basis for use of an appraisal valuation. Thereafter, such portfolio investments are carried at appraised values as determined quarterly. Because of the inherent uncertainty of the valuation of portfolio securities which do not have readily ascertainable market values, the Fund's estimate of fair value may significantly differ from the fair value that would have been used had a ready market existed for the securities. At December 31, 2000, approximately 96%

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of the Fund's fair value of portfolio securities were invested in securities for which market quotations were not readily available. See "Valuation".

POSSIBLE VOLATILITY OF STOCK PRICE. The market price of the Fund's common stock could be subject to significant fluctuations in response to variations in the net asset value of the Fund, its quarterly operating results, and other factors. The market price of the common stock may be significantly affected by such factors as the announcement of new or follow-on investments in portfolio companies, the sale or proposed sale of a portfolio investment, the results of operations or fluctuations in the market prices or appraised value of one or more of the Fund's portfolio companies, changes in earnings estimates by market analysts, speculation in the press or analyst community and general market conditions or market conditions specific to particular industries. From time to time in recent years, the securities markets have experienced significant price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies. These broad fluctuations may adversely affect the market price of the common stock. In addition, the Fund is subject to the risk of the securities markets in which the portfolio securities of the Fund are traded. Securities markets are cyclical and the prices of the securities traded in such markets rise and fall at various times. These cyclical periods may extend over significant periods of time.

REGULATION

The Investment Advisers Act generally prohibits investment advisers from entering into investment advisory contracts with an investment company that provides for compensation to the investment adviser on the basis of a share of capital gains or capital appreciation of the portfolio investments or any portion of the funds of the investment company or pursuant to a stock option plan. The Investment Advisers Act, however, does permit the payment of compensation based on capital gains or the issuance of incentive stock options

to management in an investment advisory contract between an investment adviser and a business development company. The Fund has elected to be treated as a business development company under the Investment Company Act. Accordingly, it has provided for incentive compensation to the Management Company based on an incentive stock option plan established in 1997.

The Fund may not withdraw its election to be treated as a business development company without first obtaining the approval of a majority in interest of its shareholders. The following brief description of the Investment Company Act is qualified in its entirety by reference to the full text of the Investment Company Act and the rules thereunder.

A business development company must be operated for the purpose of investing in the securities of certain present and former "eligible portfolio companies" or certain bankrupt or insolvent companies and must make available significant managerial assistance to portfolio companies. An eligible portfolio company generally is a company that (i) is organized under the laws of, and has its principal place of business in, any state or states, (ii) is not an investment company and (iii) (a) does not have a class of securities registered on an exchange or included in the Federal Reserve Board's over-the-counter margin list, (b) is actively controlled by the business development company acting either alone or as part of a group acting together and an affiliate of the business development company is a member of the portfolio company's board of directors or (c) meets such other criteria as may be established by the SEC. Control is presumed to exist where the business development company owns more than 25% of the outstanding voting securities of a portfolio company.

"Making available significant managerial assistance" is defined under the Investment Company Act to mean (i) any arrangement whereby a business development company, through its directors, officers or employees, offers to provide and, if accepted, does provide significant guidance and counsel

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concerning the management, operations or business objectives or policies of a portfolio company or (ii) the exercise of a controlling influence over the management or policies of a portfolio company by the business development company acting individually or as part of a group of which the business development company is a member acting together which controls such company ("Managed Company"). A business development company may satisfy the requirements of clause (i) with respect to a portfolio company by purchasing securities of such a company as part of a group of investors acting together if one person in such group provides the type of assistance described in such clause. However, the business development company will not satisfy the general requirement of making available significant managerial assistance if it only provides such assistance indirectly through an investor group. A business development company need only extend significant managerial assistance with respect to portfolio companies which are treated as Qualifying Assets (as defined below) for the purpose of satisfying the 70% test discussed below.

The Investment Company Act prohibits or restricts the Fund from investing in certain types of companies, such as brokerage firms, insurance companies, investment banking firms and investment companies. Moreover, the Investment Company Act limits the type of assets that the Fund may acquire to "Qualifying Assets" and certain assets necessary for its operations (such as office furniture, equipment and facilities) if, at the time of the acquisition, less than 70% of the value of the Fund's total assets consists of qualifying assets. Qualifying Assets include (i) securities of companies that were eligible portfolio companies at the time that the Fund acquired their securities; (ii) securities of companies that are actively controlled by the Fund; (iii) securities of bankrupt or insolvent companies that are not otherwise eligible portfolio companies; (iv) securities acquired as follow-on investments in companies that were eligible portfolio companies at the time of the Fund's initial acquisition of their securities but are no longer eligible portfolio companies, provided that the Fund has maintained a substantial portion of its initial investment in such companies; (v) securities received in exchange for or distributed on or with respect to any of the foregoing; and (vi) cash items, government securities and high-quality, short-term debt. The Investment Company Act also places restrictions on the nature of the transactions in which, and the persons from whom, securities can be purchased in order for such securities to be considered Qualifying Assets. As a general matter, Qualifying Assets may only be purchased from the issuer or an affiliate in a transaction not constituting a public offering. The Fund may not purchase any security on margin, except such short-term credits as are necessary for the clearance of portfolio transactions, or engage in short sales of securities.

The Fund is permitted by the Investment Company Act, under specified conditions, to issue multiple classes of senior debt and a single class of preferred stock senior to the common stock if its asset coverage, as defined in the Investment Company Act, is at least 200% after the issuance of the debt or the senior stockholders' interests. In addition, provisions must be made to prohibit any distribution to common shareholders or the repurchase of any shares unless the asset coverage ratio is at least 200% at the time of the distribution or repurchase.

The Fund generally may sell its securities at a price that is below the

prevailing net asset value per share only upon the approval of the policy by shareholders holding a majority of the shares issued by the Fund, including a majority of shares held by nonaffiliated shareholders. The Fund may, in accordance with certain conditions established by the SEC, sell shares below net asset value in connection with the distribution of rights to all of its stockholders. The Fund may also issue shares at less than net asset value in payment of dividends to existing shareholders.

Since the Fund is a closed-end business development company, stockholders have no right to present their shares to the Fund for redemption. Recognizing the possibility that the Fund's shares might trade at a discount, the Board of Directors of the Fund has determined that it would be in the best interest of stockholders for the Fund to be authorized to attempt to reduce or eliminate a market value discount

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from net asset value. Accordingly, the Fund from time to time may, but is not required to, repurchase its shares (including by means of tender offers) to attempt to reduce or eliminate any discount or to increase the net asset value of its shares, or both.

The Fund may repurchase its shares, subject to the restrictions of the Investment Company Act. During 2000, the Fund completed the 300,000 share repurchase program begun in 1999 by repurchasing 191,127 shares for \$1,976,152. The 300,000 shares were repurchased for a total of \$3,187,450 at an average discount of 34.2% from net asset value. On May 11, 2000 the Fund announced another repurchase program pursuant to which the Fund repurchased 241,800 shares of common stock in open market transactions for \$2,542,735. The 241,800 shares were repurchased at an average discount of 36.4% from net asset value.

Many of the transactions involving the Fund and its affiliates (as well as affiliates of such affiliates) require the prior approval of a majority of the Independent Directors and a majority of the Independent Directors having no financial interest in the transactions. However, certain transactions involving closely affiliated persons of the Fund, including the Management Company, require the prior approval of the SEC. In general (a) any person who owns, controls or holds with power to vote more than 5% of the outstanding shares, (b) any director or executive officer and (c) any person who directly or indirectly controls, is controlled by or is under common control with such person, must obtain the prior approval of a majority of the Independent Directors and, in some situations, the prior approval of the SEC, before engaging in certain transactions involving the Fund or any company controlled by the Fund. In accordance with the Investment Company Act, a majority of the directors must be persons who are not "interested persons" as defined in such act. Except for certain transactions which must be approved by the Independent Directors, the Investment Company Act generally does not restrict transactions between the Fund and its Portfolio Companies.

ITEM 2. PROPERTIES.

The Fund does not have an interest in any physical properties.

ITEM 3. LEGAL PROCEEDINGS.

The Fund, its affiliates and certain of the Portfolio Companies are involved in asserted claims and have the possibility for unasserted claims which may ultimately affect the net asset value of the Fund or the fair value of the Fund's portfolio investments.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted to a vote of security holders during the fourth quarter of 2000.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The Fund's shares of common stock began to trade on the New York Stock Exchange on May 13, 1998, under the symbol "EQS". Prior to May 13, 1998, the Fund's shares traded on the American Stock Exchange under the same symbol. The Fund had approximately 6,800 shareholders at December 31, 2000, 1,500 of which were registered holders. Registered holders do not include those shareholders whose stock has been issued in street name. The net asset value per share of the Fund's common stock at December 31, 2000, was \$15.40.

The following table reflects the high and low sales prices per share of the Fund's common stock on the New York Stock Exchange for the two years ended December 31, 2000, by quarter.

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QUARTER ENDED	HIGH	LOW
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03/31/99	\$ 16.625	\$ 14.063

06/30/99	\$ 16.250	\$ 14.188
09/30/99	\$ 16.750	\$ 14.875
12/13/99	\$ 16.312	\$ 10.125
03/31/00	\$ 10.625	\$ 9.813
06/30/00	\$ 10.688	\$ 9.938
09/30/00	\$ 10.688	\$ 10.313
12/31/00	\$ 10.688	\$ 8.500

As a regulated investment company under Subchapter M of the Code, the Fund is required to distribute to its shareholders, in a timely manner, at least 90% of its taxable net investment income each year. If the Fund distributes, in a timely manner, 98% of its taxable net capital gains and 98% of its taxable net investment income each year (as well as any portion of the respective 2% balances not distributed in the previous year), it will not be subject to the 4% non-deductible federal excise tax on certain undistributed income of regulated investment companies. Under the Investment Company Act, the Fund is not permitted to pay dividends to shareholders unless it meets certain asset coverage requirements.

Historically, net investment income and net realized gains from the sale of portfolio investments have been distributed at least annually. The Fund declared dividends of \$3,843,842 (\$0.60 per share), \$23,814,714 (\$4.25 per share) and \$3,138,520 (\$0.65 per share) during 2000, 1999 and 1998, respectively. The Fund has adopted a policy to make dividend distributions of at least \$0.60 per share on an annual basis. In the event that taxable income, including realized capital gains, exceeds \$0.60 per share in any year, additional dividends may be declared to distribute such excess. The 2000, 1999 and 1998 dividends were paid in additional shares of common stock or in cash by specific election of each shareholder in December 2000, 1999 and 1998, respectively. The 2000 dividend represented long-term capital gains carried over from 1999, ordinary income and was primarily a return of capital. The 1999 and 1998 dividends represented long-term capital gains. The Fund paid \$1,482,244, \$9,511,374 and \$991,853 in cash and issued 268,173, 1,337,542 and 125,812, additional shares of stock at \$8.80625, \$10.69375 and \$17.0625 per share in December 2000, 1999 and 1998 respectively, in connection with such dividends. In 2000 and 1999, the Fund recorded non-cash compensation expense for the dividends paid on stock held by the officers of \$388,663 and \$2,085,766, respectively, in accordance with generally accepted accounting principles ("GAAP"). See footnote 10 for discussion related to GAAP requirements.

The Fund is investing in companies that it believes have a high potential for capital appreciation, and the Fund intends to realize the majority of its profits upon the sale of its investments in Portfolio Companies. Consequently, most of the companies in which the Fund invests do not have established policies of paying annual dividends.

A portion of the investments in portfolio securities held by the Fund is comprised of interest-bearing subordinated debt securities or dividend-paying preferred stock. The Fund will continue to distribute taxable net investment income earned on these investments from time to time, to the extent not retained for follow-on investments, expenses and contingencies. If taxable net investment income is retained, the Fund will be subject to federal income tax.

The Fund reserves the right to retain net long-term capital gains in excess of net short-term capital losses for reinvestment or to pay contingencies and expenses. Such retained amounts, if any, will

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be taxable to the Fund as long-term capital gains and shareholders will be able to claim their proportionate share of the federal income taxes paid by the Fund on such gains as a credit against their own federal income tax liabilities. Stockholders will also be entitled to increase the adjusted tax basis of their Fund shares by the difference between their undistributed capital gains and their tax credit.

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ITEM 6. SELECTED FINANCIAL DATA.

Following is a summary of selected financial data and per share data of the Fund and its predecessors for the five years ended December 31, 2000. Amounts are in thousands except per share data.

	2000	1999	1998	1997	1996
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Total investment income	\$ 5,117	\$ 5,157	\$ 3,774	\$ 4,013	\$ 2,590
Net investment income (loss)	\$ 549	\$ (2,177)	\$ (2,179)	\$ (922)	\$ (8,267)
Realized gain (loss) on dispositions of portfolio securities, net	\$ (6,161)	\$ 40,353	\$ (3,564)	\$ 7,566	\$ 4,037
Increase (decrease) in unrealized appreciation of portfolio securities, net	\$ 282	\$ (45,412)	\$ (21,581)	\$ 24,222	\$ 33,696
Total increase (decrease) in net assets from operations	\$ (5,329)	\$ (7,237)	\$ (27,324)	\$ 30,865	\$ 29,467
Dividends	\$ 3,844	\$ 23,815	\$ 3,139	\$ 2,380	\$ 3,180
Total assets at end of year	\$ 176,018	\$ 175,022	\$ 215,603	\$ 228,095	\$ 181,166
Net assets at end of year	\$ 90,925	\$ 101,419	\$ 116,155	\$ 144,471	\$ 103,223
Net cash used by operating activities	\$ (2,191)	\$ (3,303)	\$ (4,298)	\$ (1,043)	\$ (2,494)
Shares outstanding at end of year	5,903	6,108	4,954	4,828	4,301
Average shares outstanding during year	5,870	4,950	4,829	4,733	3,819

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2000, the Fund had \$94,117,912 of its assets invested in portfolio securities of 27 companies, and has committed to invest up to an additional \$8,968,500 in six of such companies and up to \$6,120,000 in two new companies. Current temporary cash investments, anticipated future investment income, proceeds from borrowings, and proceeds from the sale of existing portfolio securities are believed to be sufficient to finance these commitments. At December 31, 2000, the Fund had \$7,300,000 outstanding on a \$32,500,000 revolving line of credit loan from a bank.

Net cash used by operating activities was \$2,191,287, \$3,302,678 and \$4,298,452 for the three years ended December 31, 2000, respectively.

At December 31, 2000, the Fund had \$77,041,332 of its total assets of \$176,017,567 invested in temporary cash investments consisting of money market securities. This amount includes proceeds of \$77,000,000 from a \$100,000,000 note payable to a bank that is utilized to enable the Fund to achieve adequate diversification to maintain its pass-through tax status as a regulated investment company. Such amount was repaid to the bank on January 2, 2001.

The Fund has the ability to borrow funds and issue forms of senior securities representing indebtedness or stock, such as preferred stock, subject to certain restrictions. Net investment income and net realized gains from the sales of portfolio investments are intended to be distributed at least annually, to the extent such amounts are not reserved for payment of contingencies or to make follow-on or new investments. Management believes that the availability under its line of credit, as well as the ability to sell its investments in publicly traded securities, are adequate to provide payment for any expenses and contingencies of the Fund.

The Fund reserves the right to retain net long-term capital gains in excess of net short-term capital losses for reinvestment or to pay contingencies and expenses. Such retained amounts, if any, will be taxable to the Fund as long-term capital gains and stockholders will be able to claim their proportionate share of the federal income taxes paid by the Fund on such gains as a credit against their own federal income tax liabilities. Stockholders will also be entitled to increase the adjusted tax basis of their Fund shares by the difference between their undistributed capital gains and their tax credit.

The Fund may repurchase its shares, subject to the restrictions of the Investment Company Act. During 2000, the Fund completed the 300,000 share repurchase program begun in 1999 by repurchasing 191,127 shares for \$1,976,152. The 300,000 shares were repurchased for \$3,187,450 at an average discount of 34.2% from net asset value. On May 11, 2000, the Fund announced another repurchase program, pursuant to which the Fund repurchased 241,800 shares of common stock in open market transactions for \$2,542,735. The 241,800 shares were repurchased at an average discount of 36.4% from net asset value.

RESULTS OF OPERATIONS

INVESTMENT INCOME AND EXPENSE

Net investment income (loss) after all expenses amounted to \$549,448, \$(2,177,164) and \$(2,178,659) for the three years ended December 31, 2000. Income from portfolio securities was \$4,629,928 in 2000, \$5,060,617 in 1999 and \$3,726,430 in 1998. Amounts invested in interest- and

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dividend-bearing portfolio securities were higher during 2000 and 1999 as compared to 1998. Interest from temporary cash investments was \$141,427 in 2000, \$57,908 in 1999 and \$48,004 in 1998. The increase in 2000 as compared to 1999 and 1998 was a result of higher investable balances throughout the year. Generally accepted accounting principles require that the options issued to officers be accounted for using the variable plan accounting due to the limited recourse provision of such notes. Therefore, interest recorded on the non-recourse portion of the notes is required to be recorded as an increase in additional paid-in capital. Interest income on notes receivable from officers was \$101,318 in 2000 and \$38,405 in 1999. The increase in 2000 as compared to 1999 is due to interest being accrued for a full year in 2000 as compared to only one quarter in 1999. The percentage used to calculate the compensation expense for the non-recourse portion of the interest has increased to 82% in 2000 as compared to 75% in 1999 as a result of payments made on the notes. The notes receivable from the officers of the Fund were received on September 30, 1999 as payment for common stock issued upon exercise of stock options pursuant to the Stock Incentive Plan discussed below.

The net investment income in 2000 as compared to the net investment loss in 1999 and 1998 was primarily attributable to a decrease in interest expense and compensation expense in 2000. Interest expense was \$1,508,788 in 2000 as compared to \$2,163,593 in 1999 and \$1,970,973 in 1998 due to changes in the average daily balances outstanding on the lines of credit to \$18,950,064 in 2000, from \$26,855,068 in 1999 and \$23,469,957 in 1998. In addition, due to the limited recourse provision of the notes receivable from the officers issued in 2000 and 1999, generally accepted accounting principles require that any dividends paid on the non-recourse portion of the notes be treated as non-cash compensation expense in the statement of operations. Accordingly, the Fund recorded non-cash compensation expense of \$388,663 and \$2,085,766 related to its dividend in 2000 and 1999, respectively. The decrease in 2000 as compared to 1999 was a result of a \$0.60 dividend per share in 2000 as compared to a \$4.25 dividend per share in 1999. The amount of the compensation expense was also recorded as an increase in additional paid in capital, and therefore had no effect on the Fund's net asset value.

Mailing, printing and other expenses were \$172,339 during 2000, as compared to \$214,947 during 1999 and \$383,644 during 1998. The reduction in 2000 and 1999 expenses as compared to 1998 is due to the lower cost for the preparation and distribution of the annual report and proxy statement for the annual shareholders' meeting held in May 2000 and to be held in May 2001.

Professional fees decreased to \$167,785 during 2000 as compared to \$279,141 during 1999 and \$490,954 during 1998. The decrease in 2000 compared to 1999 is due primarily to a reduction in fees paid to an investor relations consulting firm and a refund of legal fees in the amount of \$34,998 received related to Paracelsus Healthcare Corporation shareholder litigation. The decrease in 1999 compared to 1998 is due primarily to the higher costs associated with the New York Stock Exchange listing in 1998.

The Management Company receives management fee compensation at an annual rate of 2% of the net assets of the Fund paid quarterly in arrears. Such fees amounted to \$1,911,275, \$2,179,413 and \$2,706,325 during 2000, 1999 and 1998, respectively. The lower amounts during the year ended December 31, 2000 and 1999 were due to the decrease in net assets during the years.

Shareholders have approved the Equus II Incorporated 1997 Stock Incentive Plan ("Stock Incentive Plan") which authorizes the Fund to issue options to the directors and officers of the Fund in an aggregate amount of up to 20% of the outstanding shares of common stock of the Fund. The Stock Incentive Plan also provides that each director who is not an officer of the Fund is, on the first business day following each annual meeting, granted an incentive stock option to purchase 2,000 shares of the Fund's common stock. On May 10, 2000, options to acquire a total of 12,000 shares at \$9.94 per share were issued to the directors. During 1999, two directors each exercised 1,000 of their options to acquire

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a total of 2,000 shares for \$15.5625 per share.

Under the Stock Incentive Plan, options to purchase 306,773 and 294,773 shares of the Fund's common stock with a weighted average exercise price of \$18.71 and \$19.07 per share were outstanding at December 31, 2000 and 1999, respectively. Of these options, 261,970 and 91,150 shares, with a weighted

average exercise price per share of \$18.96 and \$22.33, were exercisable at December 31, 2000 and 1999, respectively. Outstanding options at December 31, 2000 have exercise prices ranging from \$9.94 to \$27.44 and expire in May 2007 through May 2010. On September 30, 1999, options to purchase 654,358 shares of common stock of the Fund were exercised by the officers of the Fund for \$17 per share. The exercise price of \$11,124,086 was paid in the form of promissory notes from the officers to the Fund. The notes bear interest at 5.42% per annum, have limited recourse and are due on or before September 30, 2008. The notes are secured by the 654,358 shares, including any proceeds or dividends paid thereon. During 2000 and 1999, a dividend of \$0.60 and \$4.25 per share was paid, respectively. As a result of these dividends in 2000 and 1999, 42,723 and 135,608 additional shares, respectively, were issued to the officers and pledged to the Fund. In addition, principal payments of \$991,161, representing 58,304 shares, were made on the notes in 1999. As a result of the additional shares issued and payments made, the notes are secured by 832,689 and 789,966 shares of common stock and the outstanding balance on the notes was \$10,132,925 at December 31, 2000 and 1999, respectively.

The notes receivable, as well as 771,927 and 731,662 of such shares of common stock, are not included in the Fund's reported net asset value per share at 2000 and 1999, respectively. The shares of stock financed by the notes from the officers will be included in the net asset value per share as the shares are paid for or released from collateral. The pledged shares included in the calculation of net asset value is determined based on the percentage of the officers' notes paid multiplied by the shares pledged. Pledged shares included in the calculation of net asset value included 60,762 and 58,304 shares at December 31, 2000 and 1999, respectively. Shares may be released as payments on the notes are made or as the value of the collateral increases. Generally accepted accounting principles require that the options issued to the officers be accounted for using variable plan accounting due to the limited recourse provision of such notes. Additionally, the dividends paid on the common stock pledged on the non-recourse portion of the notes are required to be recorded as compensation expense in the statements of operations, and interest recorded on the non-recourse portion of the notes is required to be recorded as an increase to additional paid-in capital. Accordingly, for the years ended December 31, 2000 and 1999, dividends of \$388,663 and \$2,085,766 were recorded as non-cash compensation expense and interest of \$447,887 and \$115,217 was credited to additional paid-in capital. Additionally, the limited recourse notes receivable from the officers are required to be recorded as a reduction of net assets. If the notes and the shares were included in the Fund's balance sheet, the net asset value would have been \$15.14 and \$16.31 per share at December 31, 2000 and 1999, respectively.

As of December 31, 2000 and 1999, all outstanding options were "out of the money" and would not have had a dilutive effect on net assets per share if exercised, assuming the Fund would use the proceeds from the exercise of such options to repurchase shares at the market price pursuant to the treasury stock method.

REALIZED GAINS AND LOSSES ON DISPOSITIONS OF PORTFOLIO SECURITIES

During the year ended December 31, 2000, the Fund realized net capital losses of \$6,160,547 from the sale or write-off of securities of Portfolio Companies as follows:

- o sold 900,000 shares of Allied Waste Industries, Inc. for \$11,656,249, realizing a capital gain of \$8,534,684;
- o sold 1,703,200 shares of Drypers Corporation for \$83,294, realizing a capital loss of \$7,270,556;
- o sold 173,868 shares of Paracelsus Healthcare Corporation for \$4,460, realizing a capital loss of \$974,839;
- o sold 255,103 shares of LG&E Energy Corporation for \$6,193,867, realizing a capital gain of \$1,911,944;
- o a receivable from Restaurant Development Group was written-off, realizing a capital loss of \$8,315;
- o the preferred stock of Hot & Cool Holdings, Inc. was sold for \$1, realizing a capital loss of \$1,086,631;
- o the remaining shares of Drypers Corporation were written-off, realizing a capital loss of \$1,974,706, and
- o the preferred & common stock of The Drilltec Corporation was written-off, realizing a capital loss of \$7,645,000.

In addition, additional compensation related to the previous sale of three Portfolio Companies was received. The Fund realized a capital gain of \$680,636 as a result of additional compensation from the escrow account related to the 1998 sale of WMW Industries. The Fund realized a capital gain of \$683,697 as a result of additional compensation from the escrow account related to the 1999

sale of HTD Corporation. Also, during the year, the Fund received proceeds from Video Rental of Pennsylvania, Inc. in the amount of \$3,722,349 for repayment of the outstanding notes payable and \$250,000 for redemption of the common and preferred stock and did not realize a capital gain. The Fund also received proceeds from the liquidation of Equus Video Corporation and realized a capital loss of \$5,919. The Fund also received \$3,500,000 from Champion Window, Inc. in payment of a 12% subordinated promissory note, which did not result in a capital gain or loss. Also, as a result of the earnout related to the sale of CRC Holdings Corp. in 1999, the Fund received cash of \$994,458 and 17,739 shares of LGE and realized the \$994,458 as a capital gain.

During the year ended December 31, 1999, the Fund realized a net capital gain of \$40,352,644 from the sale of securities of Portfolio Companies as follows:

- o sold 54,334 shares of United Rentals, Inc. for \$1,738,036, realizing a capital gain of \$1,737,639;
- o sold 135,472 common shares of United States Filter Corporation for \$3,884,978, realizing a capital gain of \$2,324,700;
- o sold 100,000 shares of Allied Waste Industries, Inc. common stock for \$1,832,122, realizing a capital gain of \$1,357,966;
- o sold 1,125,000 shares of American Residential Services, Inc. for \$6,468,750, realizing a capital gain of \$3,468,478;
- o sold 149,337 shares of Travis International, Inc. for \$6,668,987, realizing a capital gain of \$6,114,095;
- o sold its investments in HTD Corporation for \$12,877,114, realizing a capital gain of \$3,341,547;
- o sold its investment in CRC Holdings, Corp., realizing a capital gain of \$12,128,572;
- o sold its investment in Carruth-Doggett Industries, Inc. for \$7,309,250, realizing a capital gain of \$5,059,250;
- o sold its investment in CDI Rental Services Inc. for \$2,103,250, realizing a capital gain of

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\$103,250; and

- o sold 474,942 shares of Garden Ridge Corporation for \$5,461,833, resulting in a capital gain of \$4,776,803.

During 1999, the Fund sold CRC Holdings to LG&E Corp. ("LGE") and received \$12,128,572 in cash and 121,504 shares of LGE common stock. An additional 115,860 shares of LGE stock were held in escrow to secure contractual representations and warranties. In addition, LGE was obligated to pay up to an additional \$11.7 million to the Fund if the CRC business sold to LGE achieves certain annual levels of financial performance through March 31, 2002.

The Fund also realized a capital gain as a result of the receipt of \$654,570 in additional compensation from the escrow account related to the 1998 sale of WMW Industries. In addition, Atlas Acquisition paid \$128,298 in principal on its outstanding junior participation note and the Fund realized a loss of \$721,702 on the remaining balance of the note. The Fund also realized a capital gain as a result of the receipt of \$7,536, as payment on preferred stock of Springtime, Inc., which had been previously written off as having no value. In addition, a capital loss of \$60 was realized on the write-off of CDR Fleet Services as a result of the CDI Rental Services and Carruth-Doggett Industries, Inc. sale.

During the year ended December 31, 1998, the Fund realized a net capital loss of \$3,563,556 from the sale or write-off of securities of eleven Portfolio Companies as follows:

- o sold 143,112 shares of Coach USA, Inc. common stock for \$6,620,305, realizing a capital gain of \$4,756,948;
- o sold 32,128 shares of United States Filter Corporation common stock for \$1,059,964, realizing a capital gain of \$679,111;
- o sold 225,000 shares of Allied Waste Industries, Inc. for \$4,710,866, realizing a capital gain of \$3,644,015;
- o its investment in Atlas Acquisition, Inc. was written off, realizing a capital loss of \$2,000,000;
- o its investment in Brazos Sportswear, Inc. was written off, realizing a capital loss of \$8,235,367; and

o its investment in Restaurant Development Group was liquidated, realizing a capital loss of \$2,089,432.

In addition, the Fund realized a capital gain due to the receipt of \$6,825 in additional compensation from the escrow account related to the 1997 sale of Cardiovascular Ventures, Inc. The Fund realized a capital loss of \$735,525 on the conversion of its prime + 1% note due from Triad Medical Inc. into a non-interest bearing loan due in 2005. The value of the note was discounted by \$735,525, representing original issue discount that will be accreted to income over the life of the loan. The Fund also realized a loss of \$212,980 from the reduction in the value of the royalty receivable due from United Rentals, Inc. related to the 1997 sale of J&J Rental Services, Inc. The Fund realized a capital gain due to the receipt of additional proceeds of \$575,708 related to the 1997 sale of the Fund's investment in Industrial Equipment Rentals, Inc. The Fund also realized a capital gain due to the receipt of \$47,141 as payment on preferred stock of Springtime, Inc., which had been previously written off as having no value.

UNREALIZED APPRECIATION AND DEPRECIATION OF PORTFOLIO SECURITIES

Net unrealized depreciation decreased by \$281,625 during the year ended December 31, 2000,

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from \$1,100,588 to \$818,963. Such net decrease resulted from an increase in estimated fair value of securities of eight of the Fund's Portfolio Companies of \$11,678,434, a decrease in estimated fair value of securities of nine of the Fund's Portfolio Securities of \$15,789,610 and the transfer of \$4,392,801 in net unrealized depreciation to net realized losses from the sale or disposition of investments in eight Portfolio Companies.

Net unrealized appreciation on investments decreased \$45,412,285 during the year ended December 31, 1999, from unrealized appreciation of \$44,311,697 to unrealized depreciation of \$1,100,588. Such net decrease resulted from decreases in the estimated fair value of securities of nine of the Fund's Portfolio Companies aggregating \$24,818,186, an increase in the estimated fair value of securities of seven of the Fund's Portfolio Companies of \$9,528,986 and the transfer of \$30,123,085 in net unrealized appreciation to net realized gains from the sale or disposition of investments in ten Portfolio Companies. The significant increase in net unrealized depreciation in 1999 as compared to 1998 was primarily attributable to the transfer of unrealized appreciation resulting from the sales of CRC Holdings, Inc. and Travis International, Inc. and the decline in stock prices of the Fund's publicly-traded securities.

Net unrealized appreciation on investments decreased \$21,581,656 during the year ended December 31, 1998, from \$65,893,353 to \$44,311,697. Such net decrease resulted from decreases in the estimated fair value of securities of eight of the Fund's Portfolio Companies aggregating \$35,408,412, an increase in the estimated fair value of securities of twelve portfolio companies of \$30,539,019, and the transfer of \$5,504,231 and \$11,208,032 in net unrealized appreciation to net realized losses from the sale of investments in three companies and the write off of investments in two companies, respectively. The significant decrease in net unrealized appreciation in 1998 as compared to 1997 is primarily attributable to the decline in stock price of the Fund's publicly-traded securities, the write down of investments in two other portfolio companies providing equipment and services to the oil and gas industry and the write off of investments in two other portfolio companies.

DIVIDENDS

The Fund declared dividends of \$3,843,842 (\$0.60 per share), \$23,814,714 (\$4.25 per share) and \$3,138,520 (\$0.65 per share) during 2000, 1999 and 1998, respectively. The Fund has adopted a policy to make dividend distributions of at least \$0.60 per share on an annual basis. In the event that taxable income, including realized capital gains, exceeds \$0.60 per share in any year, additional dividends may be declared to distribute such excess. The 2000, 1999 and 1998 dividends were paid in additional shares of common stock or in cash by specific election of each shareholder in December 2000, 1999 and 1998, respectively. The 2000 dividend represented long-term capital gains carried over from 1999, ordinary income and was primarily a return of capital. The 1999 and 1998 dividend represented long-term capital gains. The Fund paid \$1,482,244, \$9,511,374 and \$991,853 in cash and issued 268,173, 1,337,542 and 125,812 additional shares of stock at \$8.80625, \$10.69375 and \$17.0625 per share, in December 2000, 1999 and 1998, respectively, in connection with such dividends. In 2000 and 1999, the Fund recorded non-cash compensation expense for the dividends paid on stock held by officers of \$388,663 and \$2,085,766, respectively, in accordance with GAAP.

PORTFOLIO INVESTMENTS

During the year ended December 31, 2000, the Fund invested \$7,435,001 in four new companies and made follow-on investments of \$4,968,405 in ten portfolio companies. These follow-on investments include \$1,209,344 in accrued interest and dividends received in the form of additional portfolio securities and accretion of original issue discount on a promissory note.

During 2000, the Fund advanced \$476,000 to The Drilltec Corporation pursuant to a prime plus 9.75% promissory note, \$571,496 to Equicom, Inc. pursuant to a 10% promissory note, \$500,000 to Hot & Cool Holdings, Inc. pursuant to a 12% promissory note and \$585,000 to United Industrial Services, Inc. pursuant to a 15% promissory note.

During the year ended December 31, 2000, the Fund received an additional 4,593 and 1,363 shares of preferred stock of Container Acquisition, Inc. and Sovereign Business Forms, Inc. ("Sovereign") in payment of \$459,300 and \$136,300 in dividends, respectively. In addition, Sovereign elected to convert \$493,744 of accrued interest into the balance of the 15% promissory note due to the Fund.

On February 28, 2000, the Fund invested an additional \$726,565 in Summit/DPC Partners to allow the partnership to purchase additional shares of Doane Pet Care Enterprises, Inc. common stock

On March 15, 2000, the Fund committed to invest up to \$3,000,000 in Sternhill Partners I, L.P., a venture capital fund formed to invest in private, early-stage, emerging-growth companies involved in information technology and, on limited occasions, life science technologies. The Fund's investment consists of a 3% limited partnership interest. Through December 31, 2000, \$900,000 of such commitment had been funded.

During the year ended December 31, 2000, the original issue discount accretion on the discounted \$4,000,000, 12% subordinated promissory note due from Turfgrass America, Inc. ("Turfgrass") amounted to \$120,000, bringing the balance of the note to \$3,595,000 at December 31, 2000. The original issue discount is being accreted over the life of the note.

In March of 2000, the Fund committed to invest up to \$3,000,000 in Vanguard VII, L.P., a venture capital fund formed to invest in seed and early stage communications, internet and life sciences technology companies. The Fund's investment consists of a 1.3% limited partnership interest. Through December 31, 2000, \$600,000 of such commitment had been funded.

During May 2000, the Fund invested \$1,335,001 in the Bradshaw Group, a company that provides innovative printing solutions primarily for customers in need of high speed mass printings. The Fund's investment consists of 1,335,000 shares of preferred stock and a warrant to acquire 2,229,450 shares of common stock at \$0.01 per share through May 2008.

During June 2000, the Fund invested \$5,500,000 in FS Strategies, Inc., a company formed to acquire the stock of Talent Tree Acquisition Corporation (formerly Initial Staffing Services) and EESIS, Inc. ("EESIS"). Talent Tree provides temporary staffing and permanent placement services. EESIS is a web based human resources solutions provider. The Fund's investment consists of 110,000 shares of common stock.

During the year ended December 31, 1999, the Fund invested \$20,638,398 in six new companies and made follow-on investments of \$10,591,965 in eleven portfolio companies. These follow-on investments include \$1,388,132 in accrued interest and dividends received in the form of additional portfolio securities and accretion of original issue discount on a promissory note. The Fund also received note payments and proceeds from the sale of portfolio securities of \$4,933,338 in the form of additional portfolio securities.

During the year ended December 31, 1998, the Fund invested \$13,645,100 in three new companies and made follow-on investments of \$33,087,284 in eleven portfolio companies, including \$1,998,989 in dividends and accrued interest received in the form of additional portfolio securities and accretion of original issue discount on a promissory note.

For a description of the business of each Portfolio Company in which the Fund has invested, see "Current Portfolio Companies".

Of the companies in which the Fund has investments at December 31, 2000, only NCS, PLHC, RTEL and The ServiceMaster Company ("SVM") are publicly held. The others each have a small number of shareholders and do not generally make financial information available to the public. However, each company's operations and financial information are reviewed by Management to determine the proper valuation of the Fund's investment. See "Valuation".

SUBSEQUENT EVENTS

Subsequent to December 31, 2000, the Fund repaid a net \$75,600,000 of notes payable to the bank.

On February 6, 2001, the Board of Directors of the Fund authorized the repurchase of up to 5% of the outstanding common stock of the Fund, from time to time in open market transactions.

On February 7, 2001, the Fund invested an additional \$300,000 in Sternhill Partners I, L.P.

On February 9, 2001, the Fund invested \$1,116,550 in American Trenchless Technology, LLC ("American Trenchless") in exchange for 100,000 units of Series A preferred stock and 1,934,532 units of common stock. American Trenchless provides underground boring and tunneling services to its customers.

On February 9, 2001, the Fund invested \$3,686 in Reliant Window Holding, LLC ("Reliant") and received 36.86% membership interest in Reliant. In addition, the Fund committed to invest up to \$5,000,000 in Reliant under certain circumstances. Reliant was formed to invest in Reliant Building Products, Inc., which manufactures, distributes and installs aluminum and vinyl residential windows.

On February 28, 2001, the Fund sold its investment in Stephen L. LaFrance Holdings, Inc. for \$10,000,000, realizing a capital gain of \$7,501,548.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Fund is subject to financial market risks, including changes in interest rates with respect to its investments in debt securities and its outstanding debt payable, as well as changes in marketable equity security prices. The Fund does not use derivative financial instruments to mitigate any of these risks. The return on the Fund's investments is generally not affected by foreign currency fluctuations.

The Fund's investment in portfolio securities consists of some fixed rate debt securities. Since the debt securities are generally priced at a fixed rate, changes in interest rates do not directly impact interest income. In addition, changes in market interest rates are not typically a significant factor in the Fund's determination of fair value of these debt securities. The Fund's debt securities are generally held to maturity and their fair values are determined on the basis of the terms of the debt security and the financial condition of the issuer.

Borrowings under the Fund's \$32.5 million line of credit expose the Fund to certain market risks. Based on the average outstanding borrowings under the line of credit for the year ended December 31, 2000 of approximately \$17,150,000, a change of one percent in the interest rate would have caused a change in interest expense of approximately \$171,500. This change would have resulted in a change of \$0.03 in the net asset value per share. The Fund did not enter into its credit facility for trading purposes and the line

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of credit carries interest at a pre-agreed upon percentage point spread from either the prime rate or the 30-day LIBOR rate.

A portion of the Fund's investment portfolio consists of debt and equity investments in private companies. The Fund would anticipate no impact on these investments from modest changes in public market equity prices. However, should significant changes in market equity prices occur, there could be a longer-term effect on valuations of private companies, which could affect the carrying value and the amount and timing of gains realized on these investments. A portion of the Fund's investment portfolio also consists of common stocks in publicly traded companies. These investments are directly exposed to equity price risk, in that a hypothetical ten percent change in these equity prices would result in a similar percentage change in the fair value of these securities.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Report of Independent Public Accountants

To Equus II Incorporated:

We have audited the accompanying balance sheets of Equus II Incorporated (a Delaware corporation), including the schedules of portfolio securities, as of December 31, 2000 and 1999, and the related statements of operations, changes in net assets and cash flows for each of the three years in the period ended December 31, 2000, and the selected per share data and ratios for each of the five years in the period ended December 31, 2000. These financial statements and selected per share data and ratios are the responsibility of the management of Equus II Incorporated. Our responsibility is to express an opinion on these financial statements and selected per share data and ratios based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and selected per share data and ratios are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included physical inspection or confirmation of securities owned as of December 31, 2000, by correspondence with the custodian and brokers. An audit also includes assessing

the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3, the financial statements include investments in portfolio securities valued at \$90,328,540 (99% of net assets) and \$111,571,919 (110% of net assets) as of December 31, 2000 and 1999, respectively, whose values have been estimated by Equus Capital Management Corporation (the "Management Company") and approved by the Board of Directors of Equus II Incorporated in the absence of readily ascertainable market values. We have reviewed the procedures used by the Management Company in arriving at their estimates of value of such securities and have inspected the underlying documentation, and in the circumstances we believe the procedures are reasonable and the documentation is appropriate. However, because of the inherent uncertainty of valuation, the Management Company's estimates of values may differ significantly from the values that would have been used had a ready market existed for the securities and the differences could be material.

In our opinion, the financial statements and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of Equus II Incorporated as of December 31, 2000 and 1999, the results of its operations, changes in net assets and cash flows for each of the three years in the period ended December 31, 2000, and the selected per share data and ratios for each of the five years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

/s/ ARTHUR ANDERSEN LLP

ARTHUR ANDERSEN LLP
Houston, Texas
February 28, 2001

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EQUUS II INCORPORATED
BALANCE SHEETS
DECEMBER 31, 2000 AND 1999

	2000	1999
	-----	-----
ASSETS		
Investments in portfolio securities at fair value (cost \$94,936,875 and \$116,473,793, respectively)	\$ 94,117,912	\$ 115,373,205
Temporary cash investments, at cost which approximates fair value	77,041,332	50,334,180
Cash	2,200	5,485,502
Accounts receivable	867	1,050,606
Accrued interest receivable	4,855,256	2,778,922
	-----	-----
Total assets	\$ 176,017,567	\$ 175,022,415
	=====	=====
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	\$ 338,178	\$ 696,501
Due to management company	454,624	507,094
Notes payable to bank	84,300,000	72,400,000
	-----	-----
Total liabilities	85,092,802	73,603,595
	-----	-----
Commitments and contingencies		
Net assets:		
Preferred stock, \$.001 par value, 5,000,000 shares authorized, no shares outstanding	--	--
Common stock, \$.001 par value, 25,000,000 shares authorized, 6,674,577 and 6,839,331 shares outstanding	6,675	6,839
Additional paid-in capital	98,046,809	102,676,963
Notes receivable from officers related to 771,927 and 731,662 shares of common stock ...	(10,132,925)	(10,132,925)
Undistributed net investment income	36,936	--
Undistributed net capital gains	3,786,233	9,968,531
Unrealized depreciation of portfolio securities, net	(818,963)	(1,100,588)
	-----	-----
Total net assets	\$ 90,924,765	\$ 101,418,820
	=====	=====
Net assets per share	\$ 15.40	\$ 16.61
	=====	=====

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

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EQUUS II INCORPORATED
STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

	2000	1999	1998
	-----	-----	-----
Investment income:			
Income from portfolio securities	\$ 4,629,928	\$ 5,060,617	\$ 3,726,430
Interest from temporary cash investments	141,427	57,908	48,004
Interest on notes receivable from officers	101,318	38,405	--
Other income	244,231	--	--
	-----	-----	-----
Total investment income	5,116,904	5,156,930	3,774,434
	-----	-----	-----
Expenses:			
Management fee	1,911,275	2,179,413	2,706,325
Interest expense	1,508,788	2,163,593	1,970,973
Non-cash compensation expense	388,663	2,085,766	--
Professional fees	167,784	279,141	490,954
Director fees and expenses	239,302	269,784	244,899
Mailing, printing and other expenses	172,339	214,947	383,664
Franchise taxes	129,305	91,450	106,278
Administrative fees	50,000	50,000	50,000
	-----	-----	-----
Total expenses	4,567,456	7,334,094	5,953,093
	-----	-----	-----
Net investment income (loss)	549,448	(2,177,164)	(2,178,659)
	-----	-----	-----
Realized gain (loss) on dispositions of portfolio securities, net	(6,160,547)	40,352,644	(3,563,556)
	-----	-----	-----
Unrealized appreciation (depreciation) of portfolio securities, net:			
End of year	(818,963)	(1,100,588)	44,311,697
Beginning of year	(1,100,588)	44,311,697	65,893,353
	-----	-----	-----
Increase (decrease) in unrealized appreciation of portfolio securities, net	281,625	(45,412,285)	(21,581,656)
	-----	-----	-----
Total decrease in net assets from operations	\$ (5,329,474)	\$ (7,236,805)	\$ (27,323,871)
	=====	=====	=====

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

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EQUUS II INCORPORATED
STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

	2000	1999	1998
	-----	-----	-----
Operations:			
Net investment income (loss)	\$ 549,448	\$ (2,177,164)	\$ (2,178,659)
Realized gain (loss) on dispositions of portfolio securities, net	(6,160,547)	40,352,644	(3,563,556)
Increase (decrease) in unrealized appreciation of portfolio securities, net	281,625	(45,412,285)	(21,581,656)
	-----	-----	-----
Decrease in net assets from operations	(5,329,474)	(7,236,805)	(27,323,871)
	-----	-----	-----
Capital transactions:			
Non-cash compensation expense related to officers' stock options	388,663	2,085,766	--
Interest on non-recourse portion of officer notes	447,887	115,217	--
Stock repurchase	(4,518,887)	(1,211,298)	--
Option loans to officers, net of payments	--	(10,132,925)	--
Exercise of incentive stock options	--	11,155,211	--
Dividends	(3,843,842)	(23,814,714)	(3,138,520)
Shares issued in common stock dividend	2,361,598	14,303,340	2,146,667
	-----	-----	-----
Decrease in net assets from capital share transactions	(5,164,581)	(7,499,403)	(991,853)
	-----	-----	-----
Decrease in net assets	(10,494,055)	(14,736,208)	(28,315,724)
	-----	-----	-----
Net assets, at beginning of year	101,418,820	116,155,028	144,470,752
	-----	-----	-----
Net assets, at end of year	\$ 90,924,765	\$ 101,418,820	\$ 116,155,028
	=====	=====	=====

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

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EQUUS II INCORPORATED
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

	2000	1999	1998
	-----	-----	-----
Cash flows from operating activities:			
Interest and dividends received	\$ 2,279,113	\$ 1,780,944	\$ 1,614,656
Cash paid to management company, directors, bank and suppliers	(4,470,400)	(5,083,622)	(5,913,108)
	-----	-----	-----
Net cash used by operating activities	(2,191,287)	(3,302,678)	(4,298,452)
	-----	-----	-----
Cash flows from investing activities:			
Purchase of portfolio securities	(11,194,062)	(24,908,893)	(44,553,395)
Proceeds from dispositions of portfolio securities ...	20,565,743	55,962,420	18,382,928
Principal payments from portfolio securities	7,222,349	4,272,725	1,012,576
Proceeds from exercise of options	--	31,125	--
Repayments from (advances to) portfolio companies, net	50,263	211,640	(250,000)
	-----	-----	-----
Net cash provided (used) by investing activities	16,644,293	35,569,017	(25,407,891)
	-----	-----	-----
Cash flows from financing activities:			
Advances from bank	310,850,000	225,000,000	341,700,000
Repayments to bank	(298,950,000)	(251,100,000)	(325,100,000)
Repurchase of common stock	(4,634,820)	(1,095,365)	--
Dividends paid	(1,485,497)	(9,505,282)	(1,820,409)
Payments received on officer notes	991,161	--	--
	-----	-----	-----
Net cash provided (used) by financing activities	6,770,844	(36,700,647)	14,779,591
	-----	-----	-----
Net increase (decrease) in cash and cash equivalents	21,223,850	(4,434,308)	(14,926,752)
	-----	-----	-----
Cash and cash equivalents at beginning of year	55,819,682	60,253,990	75,180,742
	-----	-----	-----
Cash and cash equivalents at end of year	\$ 77,043,532	\$ 55,819,682	\$ 60,253,990
	=====	=====	=====

The accompanying notes are an

integral part of these financial statements.

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EQUUS II INCORPORATED
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998
(Continued)

	2000	1999	1998
	-----	-----	-----
Reconciliation of decrease in net assets from operations to net cash used by operating activities:			
Decrease in net assets from operations	\$ (5,329,474)	\$ (7,236,805)	\$ (27,323,871)
Adjustments to reconcile increase (decrease) from operations to net cash used by operating activities:			
Realized (gain) loss on dispositions of portfolio securities, net	6,160,547	(40,352,644)	3,563,556
Decrease (increase) in unrealized appreciation, net	(281,625)	45,412,285	21,581,656
Increase in accrued interest receivable	(1,628,447)	(1,987,854)	(162,228)
Accrued interest or dividends exchanged for portfolio securities	(1,209,344)	(1,388,132)	(1,997,550)
Non-cash compensation expense	388,663	2,085,766	--
Commitment fees paid	--	--	(37,500)
Amortization of commitment fee	--	31,250	25,000
Increase (decrease) in accounts payable	(239,137)	207,137	194,064
Decrease in due to management company	(52,470)	(73,681)	(141,579)
Net cash used by operating activities	\$ (2,191,287)	\$ (3,302,678)	\$ (4,298,452)
	=====	=====	=====

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

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EQUUS II INCORPORATED
SELECTED PER SHARE DATA AND RATIOS
FOR THE FIVE YEARS ENDED DECEMBER 31, 2000

	2000	1999	1998	1997	1996
	-----	-----	-----	-----	-----
SELECTED PER SHARE DATA:					
Investment income	\$ 0.87	\$ 1.04	\$ 0.78	\$ 0.85	\$ 0.68
Expenses	0.78	1.48	1.23	1.04	2.84
	-----	-----	-----	-----	-----
Net investment income (loss)	0.09	(0.44)	(0.45)	(0.19)	(2.16)
Realized gain (loss) on dispositions of					
portfolio securities, net	(1.05)	8.15	(0.74)	1.60	1.06
Increase (decrease) in unrealized					
appreciation of portfolio					
securities, net	0.05	(9.17)	(4.47)	5.11	8.82
	-----	-----	-----	-----	-----
Increase (decrease) in net					
assets from operations	(0.91)	(1.46)	(5.66)	6.52	7.72
	-----	-----	-----	-----	-----
Capital transactions:					
Dividends	(0.60)	(4.25)	(0.65)	(0.50)	(0.76)
Effect of common stock repurchases	0.51	0.10	--	--	--
Dilutive effect of shares issued in common					
stock dividend and exercise of options	(0.21)	(1.23)	(0.16)	(0.10)	(0.20)
Effect of Rights Offering	--	--	--	--	(2.47)
	-----	-----	-----	-----	-----
Net decrease in assets from					
capital transactions	(0.30)	(5.38)	(0.81)	(0.60)	(3.43)
	-----	-----	-----	-----	-----
Net increase (decrease) in net assets	(1.21)	(6.84)	(6.47)	5.92	4.29
Net assets at beginning of year	16.61	23.45	29.92	24.00	19.71
	-----	-----	-----	-----	-----
Net assets at end of year	\$ 15.40	\$ 16.61	\$ 23.45	\$ 29.92	\$ 24.00
	=====	=====	=====	=====	=====
Weighted average number of shares					
outstanding during year, in thousands	5,870	4,950	4,829	4,733	3,819
SELECTED RATIOS:					
Ratio of expenses before interest and					
non-cash compensation expense to					
average net assets	2.78%	2.84%	3.06%	3.64%	12.45%
Ratio of total expenses to average					
net assets	4.75%	6.74%	4.57%	3.98%	13.15%
Ratio of net investment income (loss)					
to average net assets					
	0.57%	(2.00)%	(1.67)%	(0.74)%	(10.02)%
Ratio of increase (decrease) in net					
assets from operations to average					
net assets	(5.54)%	(6.65)%	(20.97)%	24.92%	35.70%

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

PORTFOLIO COMPANY -----	INITIAL INVESTMENT -----	DATE OF COST -----	FAIR VALUE -----
A. C. Liquidating Corporation		February 1985	
-10% secured promissory notes		\$ 188,014	\$ --
The Bradshaw Group		May 2000	
-1,335,000 shares of preferred stock		1,335,000	1,335,000
-Warrant to buy 2,229,450 shares of common stock for \$0.01 through May 2008		1	1
Champion Window, Inc.		March 1999	
-1,400,000 shares of common stock		1,400,000	5,250,000
-20,000 shares of preferred stock		2,000,000	2,292,500
Container Acquisition, Inc.		February 1997	
-1,370,000 shares of common stock		1,370,000	2,870,000
-64,283 shares of preferred stock		6,428,300	6,428,300
-Conditional warrant to buy up to 370,588 shares of common stock at \$0.01 per share through June 2003		1,000	1,000
CRC Holdings, Corp.		June 1997	
-Earnout receivable		1,192,114	--
The Drilltec Corporation		August 1998	
-Prime +9.75% promissory note		1,000,000	1,000,000
-Warrant to buy 10% of the common equity for \$100 through September 2002		--	--
Equicom, Inc.		July 1997	
-452,000 shares of common stock		141,250	--
-657,611 shares of preferred stock		6,576,110	2,000,000
-10% promissory note		2,562,250	2,562,250
Equipment Support Services, Inc.		December 1999	
-35,000 shares of common stock		101,500	--
-35,000 shares of preferred stock		1,929,000	1,362,000
-8% promissory note		1,138,000	1,138,000
FS Strategies, Inc.		June 2000	
-110,000 shares of common stock		5,500,000	5,500,000
GCS RE, Inc.		February 1989	
-1,000 shares of common stock		132,910	600,000

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

PORTFOLIO COMPANY -----	INITIAL INVESTMENT -----	DATE OF COST -----	FAIR VALUE -----
Hot & Cool Holdings, Inc.		March 1996	
-9% increasing rate subordinated promissory note		\$1,075,000	\$ --
-10% subordinated notes		2,200,000	--
-12% promissory note		2,500,000	--
-Warrant to buy up to 14,942 shares of common stock at \$0.01 per share through March 2006		--	--
-Warrant to buy 10,000 shares of common stock at \$0.01 through February 2003		--	--
NCI Building Systems, Inc. (NYSE - NCS)		April 1989	
-200,000 shares of common stock		159,784	3,762,500
Paracelsus Healthcare Corporation (OTCBB - PLHC)		December 1990	
-1,844,345 shares of common stock		4,299,449	22,459
Petrocon Engineering, Inc.		September 1998	
-12% promissory note		4,663,356	4,663,356
-887,338 shares of common stock		635	635
-8% Series B junior subordinated promissory note		2,659,332	2,659,332
-Warrant to buy up to 1,552,571 shares of common stock at \$0.01 per share through March 2009		--	--
Raytel Medical Corporation (NASDAQ - RTEL)		August 1997	
-33,073 shares of common stock		330,730	26,872
The ServiceMaster Company (NYSE-SVM)		May 1999	
-Warrant to buy up to 29,411 shares of common stock at \$51 per share through September 2001		--	--

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

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EQUUS II INCORPORATED
SCHEDULE OF PORTFOLIO SECURITIES
DECEMBER 31, 2000
(Continued)

PORTFOLIO COMPANY -----	INITIAL INVESTMENT -----	DATE OF COST -----	FAIR VALUE -----
Sovereign Business Forms, Inc.		August 1996	
-16,011 shares of preferred stock		\$1,601,100	\$1,601,100
-15% promissory notes		2,793,744	2,793,744
-Warrant to buy 551,894 shares of common stock at \$1 per share through August 2006		--	1,062,890
-Warrant to buy 25,070 shares of common stock at \$1.25 per share through October 2007		--	42,015
-Warrant to buy 273,450 shares of common stock at \$1 per share through October 2009		--	526,637
Spectrum Management, LLC		December 1999	
-285,000 Units of Class A equity interests		2,850,000	2,850,000
Stephen L. LaFrance Holdings, Inc.		September 1997	
-2,498,452 shares of preferred stock		2,498,452	2,498,452
-Warrant to buy 269 shares of common stock for \$0.01 per share through September 2007		--	7,000,000
Sternhill Partners I, L.P.		March 2000	
-3% limited partnership interest		900,000	1,000,000
Strategic Holdings, Inc.		September 1995	
-3,089,751 shares of common stock		3,088,389	--
-3,822,157 shares of Series B preferred stock		3,820,624	3,250,000
-15% promissory note		6,750,000	6,750,000
-Warrants to buy 225,000 shares of common stock at \$0.4643 per share through August 2005		--	--
-Warrant to buy 100,000 shares of common stock at \$1.50 per share through August 2005		--	--
-Warrant to buy 2,219,237 shares of common stock at \$0.01 per share through November 2005		--	--
-1,000 shares of SMIP, Inc. common stock		150,000	--
-15% promissory note of SMIP, Inc.		175,000	175,000

The accompanying notes are an

integral part of these financial statements.

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EQUUS II INCORPORATED
SCHEDULE OF PORTFOLIO SECURITIES
DECEMBER 31, 2000
(Continued)

PORTFOLIO COMPANY -----	INITIAL INVESTMENT -----	DATE OF COST -----	FAIR VALUE -----
Summit/DPC Partners, L.P. -36.11% limited partnership interest		October 1995 \$ 3,326,565	\$ 10,000,000
Travis International, Inc. -98,761 shares of common stock		December 1986 5,398	1,500,000
Tulsa Industries, Inc. -209,089 shares of common stock -1,058 shares of Series B preferred stock -Junior participation in promissory note		December 1997 5,500,000 1,058,000 655,769	-- 1,058,000 655,769
Turfgrass America, Inc. -3,167,756 shares of common stock -12% subordinated promissory note with a face amount of \$4,000,000		May 1999 600,000 3,595,000	600,000 3,595,000
United Industrial Services, Inc. -35,000 shares of preferred stock -15% promissory note -Warrants to buy 63,637 shares of common stock at \$0.01 through June 2008 -Warrants to buy 18,887 shares of common stock at \$0.01 through March 2011		July 1998 3,500,000 585,000 100 --	2,500,000 585,000 100 --
Vanguard VII, L.P. -1.3% limited partnership interest		June 2000 600,000 -----	600,000 -----
Total		\$ 94,936,875 =====	\$ 94,117,912 =====

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

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EQUUS II INCORPORATED
SCHEDULE OF PORTFOLIO SECURITIES
DECEMBER 31, 2000
(Continued)

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

In connection with the investments in Champion Window, Inc., Container Acquisition, Inc., The Drilltec Corporation, Hot & Cool Holdings, Inc., Sovereign Business Forms, Inc., Strategic Holdings, Inc., Turfgrass America, Inc. and United Industrial Services, Inc., rights have been obtained to demand the registration of such securities under the Securities Act of 1933, providing certain conditions are met. The Fund does not expect to incur significant costs, including costs of any such registration, in connection with the future disposition of its portfolio securities.

As defined in the Investment Company Act of 1940, during the year ended December 31, 2000, the Fund was considered to have a controlling interest in Champion Window, Inc., Container Acquisition, Inc., The Drilltec Corporation, Equicom, Inc., Sovereign Business Forms, Inc., Spectrum Management LLC, Strategic Holdings, Inc., Tulsa Industries, Inc. and United Industrial Services, Inc. The fair value of the Fund's investment in Paracelus Healthcare Corporation includes a discount of \$1,518 from the closing market price to reflect the estimated effect of restrictions on the sale of such securities at December 31, 2000.

Income was earned in the amount of \$3,104,423, \$2,251,120 and \$2,542,677 for the years December 31, 2000, 1999 and 1998 respectively, on portfolio securities of companies in which the Fund has a controlling interest.

As defined in the Investment Company Act of 1940, all of the Fund's investments are in eligible portfolio companies. The Fund provides significant

managerial assistance to all of the portfolio companies in which it has invested, except Equipment Support Services, Inc., Raytel Medical Corporation, Sternhill Partners I, L.P., Summit/DPC Partners, L.P. and Vanguard VII, L.P. The Fund provides significant managerial assistance to portfolio companies that comprise 85% of the total value of the investments in portfolio companies at December 31, 2000.

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

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EQUUS II INCORPORATED
SCHEDULE OF PORTFOLIO SECURITIES
DECEMBER 31, 1999

PORTFOLIO COMPANY -----	INITIAL INVESTMENT -----	DATE OF COST -----	FAIR VALUE -----
A. C. Liquidating Corporation		February 1985	
-10% secured promissory notes		\$ 188,014	\$ --
Allied Waste Industries, Inc. (NYSE - AW)		March 1989	
-900,000 shares of common stock		3,121,565	7,561,125
Champion Window, Inc.		March 1999	
-1,400,000 shares of common stock		1,400,000	3,500,000
-20,000 shares of preferred stock		2,000,000	2,100,000
-12% subordinated promissory note		3,500,000	3,500,000
Container Acquisition, Inc.		February 1997	
-1,370,000 shares of common stock		1,370,000	3,870,000
-59,690 shares of preferred stock		5,969,000	5,969,000
-Conditional warrant to buy up to 370,588 shares of common stock			
at \$0.01 per share through June 2003		1,000	1,000
The Drilltec Corporation		August 1998	
-1,400,000 shares of common stock		1,400,000	--
-62,450 shares of preferred stock		6,245,000	--
-Prime +9.75% promissory note		524,000	524,000
-Warrant to buy 10% of the common equity for \$100 through September 2002		--	--
Drypers Corporation (NASDAQ - DYPR)		July 1991	
-3,677,906 shares of common stock		9,328,556	7,078,291
Equicom, Inc.		July 1997	
-452,000 shares of common stock		141,250	--
-657,611 shares of preferred stock		6,576,110	2,000,000
-10% promissory note		1,990,754	1,990,754
Equipment Support Services, Inc.		December 1999	
-35,000 shares of common stock		101,500	101,500
-35,000 shares of preferred stock		1,929,000	1,929,000
-8% promissory note		1,138,000	1,138,000
GCS RE, Inc.		February 1989	
-1,000 shares of common stock		132,910	300,000

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

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EQUUS II INCORPORATED
SCHEDULE OF PORTFOLIO SECURITIES
DECEMBER 31, 1999
(Continued)

PORTFOLIO COMPANY -----	INITIAL INVESTMENT -----	DATE OF COST -----	FAIR VALUE -----
Hot & Cool Holdings, Inc. -9% increasing rate subordinated		March 1996	
promissory note		\$1,075,000	\$1,075,000
-10% subordinated notes		2,200,000	2,200,000
-12% promissory note		1,500,000	1,500,000
-19,665 shares of Series A 8% preferred stock		786,631	--
-6,000 shares of Series B 8% preferred stock		300,000	--
-5,000 shares of Series C preferred stock		500,000	500,000
-Warrants to buy up to 14,942 shares of common stock at \$0.01 per share through March 2006		--	--
-Warrants to buy up to 16,316 shares of common stock at \$26.00 per share through April 2007		--	--
-Warrant to buy 10,000 shares of common stock at \$0.01 per share through February 2003		--	--
LG&E Energy Corp. (NYSE - LGE)		July 1999	
-121,504 shares of common stock		1,719,838	1,800,917
-Earnout and escrow receivable		3,754,199	6,800,000
NCI Building Systems, Inc. (NYSE - NCS)		April 1989	
-200,000 shares of common stock		159,784	3,700,000
Paracelsus Healthcare Corporation (NYSE - PLS)		December 1990	
-2,018,213 shares of common stock		5,278,748	788,372
Petrocon Engineering, Inc.		September 1998	
-12% promissory note		4,663,356	4,663,356
-887,338 shares of common stock		635	635
-8% Series B junior subordinated promissory note		2,659,332	2,659,332
-Warrant to buy up to 1,552,571 shares of common stock at \$0.01 per share through March 2009		--	--

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

PORTFOLIO COMPANY -----	INITIAL INVESTMENT -----	DATE OF COST -----	FAIR VALUE -----
Raytel Medical Corporation (NASDAQ - RTEL)		August 1997	
-33,073 shares of common stock		\$ 330,730	\$ 101,286
The ServiceMaster Company (NYSE-SVM)		May 1999	
-Warrant to buy up to 29,411 shares of common stock at \$51 per share through September 2001		--	--
Sovereign Business Forms, Inc.		August 1996	
-14,648 shares of preferred stock		1,464,800	1,464,800
-15% promissory notes		2,300,000	2,300,000
-Warrant to buy 551,894 shares of common stock at \$1 per share through August 2006		--	413,920
-Warrant to buy 25,070 shares of common stock at \$1.25 per share through October 2007		--	12,535
-Warrant to buy 273,450 shares of common stock at \$1 per share through October 2009		--	205,088
Spectrum Management, LLC		December 1999	
-285,000 Units of Class A equity interest		2,850,000	2,850,000
Stephen L. LaFrance Holdings, Inc.		September 1997	
-2,498,452 shares of preferred stock		2,498,452	2,498,452
-Warrant to buy 269 shares of common stock for \$0.01 per share through September 2007		--	3,000,000
Strategic Holdings, Inc.		September 1995	
-3,089,751 shares of common stock		3,088,389	2,568,287
-3,822,157 shares of Series B preferred stock		3,820,624	3,820,624
-15% promissory note		6,750,000	6,750,000
-Warrants to buy 225,000 shares of common stock at \$0.4643 per share through August 2005		--	187,026
-Warrant to buy 100,000 shares of common stock at \$1.50 per share through August 2005		--	--
-Warrant to buy 2,219,237 shares of common stock at \$0.01 per share through November 2005		--	1,844,687
-1,000 shares of SMIP, Inc. common stock		150,000	150,000
-15% promissory note of SMIP, Inc.		175,000	175,000

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

PORTFOLIO COMPANY -----	INITIAL INVESTMENT -----	DATE OF COST -----	FAIR VALUE -----
Summit/DPC Partners, L.P. -36.11% limited partnership interest		October 1995 \$ 2,600,000	\$ 5,500,000
Travis International, Inc. -98,761 shares of common stock		December 1986 5,398	1,000,000
Tulsa Industries, Inc. -209,089 shares of common stock		December 1997 5,500,000	--
-1,058 shares of Series B preferred stock		1,058,000	1,058,000
-Junior participation in promissory note		655,769	655,769
Turfgrass America, Inc. -3,167,756 shares of common stock		May 1999 600,000	600,000
-12% subordinated promissory note		3,475,000	3,475,000
United Industrial Services, Inc. -35,000 shares of preferred stock		July 1998 3,500,000	3,500,000
-Warrants to buy 63,637 shares of common stock at \$0.01 through June 2008		100	100
VRPI Spin Off, Inc. -100 shares of common stock		January 1988 250,000	250,000
-10% secured promissory note		2,672,349	2,672,349
-12% secured promissory note		1,050,000	1,050,000
-10,000 shares of common stock of Equus Video Corporation		25,000	20,000
Total		<u>\$ 116,473,793</u> =====	<u>\$ 115,373,205</u> =====

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

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EQUUS II INCORPORATED
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2000, 1999 AND 1998

(1) ORGANIZATION AND BUSINESS PURPOSE

Equus II Incorporated (the "Fund"), a Delaware corporation with perpetual existence, was formed by Equus Investments II, L.P. (the "Partnership") on August 16, 1991. On July 1, 1992, the Partnership was reorganized and all of the assets and liabilities of the Partnership were transferred to the Fund in exchange for shares of common stock of the Fund. The shares of the Fund trade on the New York Stock Exchange under the symbol EQS.

The Fund seeks to achieve capital appreciation by making investments in equity and equity-oriented securities issued by privately-owned companies in transactions negotiated directly with such companies. The Fund seeks to invest primarily in companies which intend to acquire other businesses, including leveraged buyouts. The Fund may also invest in recapitalizations of existing businesses or special situations from time to time. The Fund's investments in Portfolio Companies consist principally of equity securities such as common and preferred stock, but also include other equity-oriented securities such as debt convertible into common or preferred stock or debt combined with warrants, options or other rights to acquire common or preferred stock. Current income is not a significant factor in the selection of investments. The Fund elected to be treated as a business development company under the Investment Company Act of 1940, as amended.

(2) MANAGEMENT

The Fund has entered into a management agreement with Equus Capital Management Corporation, a Delaware corporation (the "Management Company"). Pursuant to such agreement, the Management Company performs certain services, including certain management and administrative services necessary for the operation of the Fund. The Management Company receives a management fee at an annual rate of 2% of the net assets of the Fund, paid quarterly in arrears. The Management Company also receives compensation for providing certain investor communication services, of which \$50,000 is included in the accompanying Statements of Operations for each of the three years ended December 31, 2000.

The Management Company is controlled by a privately-owned corporation.

As compensation for services rendered to the Fund, each director who is

not an officer of the Fund receives an annual fee of \$25,000 paid quarterly in arrears, a fee of \$3,000 for each meeting of the Board of Directors attended in person, a fee of \$1,500 for participation in each telephonic meeting of the Board of Directors and for each committee meeting attended (\$500 for each committee meeting if attended on the same day as a Board Meeting), and reimbursement of all out-of-pocket expenses relating to attendance at such meetings. In addition, each director who is not an officer of the Fund is granted incentive stock options to purchase shares of the Fund's stock from time to time. (See Note 10). Certain officers and directors of the Fund serve as directors of Portfolio Companies, and may receive and retain fees, including non-employee director stock options, from such Portfolio Companies in consideration for such service.

(3) SIGNIFICANT ACCOUNTING POLICIES

Valuation of Investments - Portfolio investments are carried at fair value with the net change in

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unrealized appreciation or depreciation included in the determination of net assets. Investments in companies whose securities are publicly traded are valued at their quoted market price, less a discount to reflect the estimated effects of restrictions on the sale of such securities ("Valuation Discount"), if applicable. Cost is used to approximate fair value of other investments until significant developments affecting an investment provide a basis for use of an appraisal valuation. Thereafter, portfolio investments are carried at appraised values as determined quarterly by the Management Company, subject to the approval of the Board of Directors. The fair market values of debt securities, which are generally held to maturity, are determined on the basis of the terms of the debt securities and the financial conditions of the issuer. Because of the inherent uncertainty of the valuation of portfolio securities which do not have readily ascertainable market values, amounting to \$90,328,540 (including \$22,459 in publicly-traded securities, net of a \$1,518 Valuation Discount) and \$111,571,919 (including \$17,228,705 in publicly-traded securities, net of a \$2,554,017 Valuation Discount) at December 31, 2000 and 1999, respectively, the Fund's estimate of fair value may significantly differ from the fair value that would have been used had a ready market existed for the securities. Appraised values do not reflect brokers' fees or other normal selling costs or management incentive fees which might become payable on disposition of such investments.

On a daily basis, the Fund adjusts its net asset value for the changes in the value of its publicly held securities and material changes in the value of its private securities and reports those amounts to Lipper Analytical Services, Inc. Weekly and daily net asset values appear in various publications, including BARRON'S and THE WALL STREET JOURNAL and the Fund's website, www.equuscap.com.

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

Cash Flows - For purposes of the Statements of Cash Flows, the Fund considers all highly liquid temporary cash investments purchased with an original maturity of three months or less to be cash equivalents.

Income Taxes - No provision for federal income taxes has been made in the accompanying financial statements as the Fund has qualified for pass-through treatment as a "regulated investment company" under Subchapter M of the Internal Revenue Code of 1986. As such, all net income is allocable to the stockholders for inclusion in their respective tax returns. Net capital losses are not allocable to the shareholders but can be carried over to offset future earnings of the Fund.

(4) BOOK TO TAX RECONCILIATION

The Fund accounts for dividends in accordance with Statement of Position 93-2 which relates to the amounts distributed by the Fund as net investment income or net capital gains, which are often not equal to the corresponding income or gains shown in the Fund's financial statements. The Internal Revenue Service approved the Fund's request, effective October 31, 1998, to change its year-end for determining capital gains for federal income tax from December 31 to October 31, which allows current year dividends to be paid prior to the end of the calendar year.

For the year ended December 31, 2000, the Fund had net investment income for book purposes of \$549,448 and \$609,034 for tax purposes. The difference between book and tax was primarily non-cash compensation expense recorded on the books related to dividends paid on shares owned by officers which secure limited recourse notes receivable by the Fund and non-taxable dividends received from one portfolio company. For tax purposes, the Fund had net capital losses of \$2,773,745 for the twelve months ended October 31, 2000. For the period of November 1, 2000 through December 31, 2000, the Fund had realized net capital gains of \$6,559,978. For the period of November 1, 1999 through

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December 31, 1999, the Fund had realized net capital gains of \$9,946,780. Therefore, the Fund, for book purposes, had net capital losses of \$6,160,547 for the year ended December 31, 2000.

For the year ended December 31, 1999, the Fund had a net investment loss for book purposes of \$2,177,164 and net investment income of \$108,174 for tax purposes. The difference between book and tax was primarily non-cash compensation expense recorded on the books related to dividends paid on shares owned by officers which secure limited recourse notes receivable by the Fund. For tax purposes, the Fund distributed net capital gains of \$23,814,714 for the twelve months ended October 31, 1999. For the period from November 1, 1999 through December 31, 1999, the Fund had undistributed capital gains of \$9,946,780. For the period from November 1, 1998 through December 31, 1998, the Fund had net capital losses of \$6,558,635. Therefore, the Fund, for book purposes, had net capital gains of \$40,352,644 for the year ended December 31, 1999.

For the year ended December 31, 1998, the Fund had a net investment loss for tax purposes and did not distribute investment income. On November 4, 1998, the Fund declared undistributed net capital gains for the ten months ended October 31, 1998 of \$2,995,079 as a dividend. In addition, on July 1, 1998, the Fund declared undistributed capital gains for 1997 of \$132,677 as a dividend. For the period from November 1, 1998 through December 31, 1998, the Fund had undistributed net capital losses of \$6,558,635. For book purposes, the Fund had net capital losses of \$3,563,556 for the year ended December 31, 1998.

The following is a reconciliation of the difference in the Fund's net realized gain or loss on the sale of portfolio securities for book and tax purposes:

	2000	1999	1998
	-----	-----	-----
Net realized gain (loss) on the dispositions of portfolio securities, book			
as of 12/31/00	\$ (6,160,547)	\$ 40,352,644	\$ (3,563,556)
Undistributed 1997 gains	--	--	132,677
Realized capital loss 11/1/98 -			
12/31/98	--	(6,558,635)	6,558,635
Realized capital gains 11/1/99 -			
12/31/99	9,946,780	(9,946,780)	--
Realized capital gains 11/01/00-			
12/31/00	(6,559,978)	--	--
	-----	-----	-----
Net realized gain (loss) on the dispositions of portfolio securities, tax			
as of 10/31/00	\$ (2,773,745)	\$ 23,847,229	\$ 3,127,756
	=====	=====	=====

(5) DIVIDENDS

The Fund declared dividends of \$3,843,842 (\$0.60 per share), \$23,814,714 (\$4.25 per share) and \$3,138,520 (\$0.65 per share) during 2000, 1999 and 1998, respectively. The Fund has adopted a policy to make dividend distributions of at least \$0.60 per share on an annual basis. In the event that taxable income, including realized capital gains, exceeds \$0.60 per share in any year, additional dividends may be declared to distribute such excess. The 2000, 1999 and 1998 dividend were paid in additional shares of common stock or in cash by specific election of the shareholders in December 2000, 1999 and 1998.

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The 2000 dividend represents long-term capital gains, ordinary income and return of capital. The 1999 and 1998 dividend represented long-term capital gains. The Fund paid \$1,482,244, \$9,511,374 and \$991,853 in cash and issued 268,173, 1,337,542 and 125,812 additional shares of stock at \$8.80625, \$10.69375 and \$17.0625 per share, in December 2000, 1999 and 1998 in connection with such dividends. In 2000 and 1999, the Fund recorded non-cash compensation expense for the dividends paid on stock held by officers of \$388,663 and \$2,085,766, respectively, in accordance with GAAP.

(6) TEMPORARY CASH INVESTMENTS

Temporary cash investments, which represent the short-term utilization of cash prior to investment in securities of portfolio companies, distributions to the shareholders or payment of loans and expenses, consist of \$77,041,332 and \$50,334,180 in money market accounts with Bank of America, N.A. earning interest at rates ranging from 4.22% to 4.90% and 4.64% to 5.21% at December 31, 2000, and 1999, respectively.

(7) ACCOUNTS RECEIVABLE

At December 31, 2000, the accounts receivable balance was \$867. At December 31, 1999, the accounts receivable balance was \$1,050,606, and primarily consisted of \$991,161 in principal due on the notes receivable from officers that were issued to the Fund when the officers exercised some of their stock

options. The \$991,161 was received in January 2000. In addition, \$38,818 was included in receivables due from two portfolio companies as reimbursement for expenses incurred on behalf of portfolio companies which was received in 2000.

(8) PORTFOLIO SECURITIES

During the year ended December 31, 2000, the Fund invested \$7,435,001 in four new companies and made follow-on investments of \$4,968,405 in ten portfolio companies, including \$1,209,344 in accrued interest and dividends received in the form of additional portfolio securities and accretion of original issue discount on a promissory note. In addition, the Fund realized a net capital loss of \$6,160,547 during the year ended December 31, 2000.

During the year ended December 31, 1999, the Fund invested \$20,638,398 in six new companies and made follow-on investments of \$10,591,965 in eleven portfolio companies, including \$1,388,132 in accrued interest and dividends received in the form of additional portfolio securities and accretion of original issue discount on a promissory note. The Fund also received note payments and proceeds from the sale of portfolio securities of \$4,933,338 in the form of additional portfolio securities. In addition, the Fund realized a net capital gain of \$40,352,644 during the year ended December 31, 1999.

During the year ended December 31, 1998, the Fund invested \$13,645,100 in three new companies and made follow-on investments of \$33,087,284 in eleven portfolio companies, including \$1,998,989 in accrued interest and dividends received in the form of additional portfolio securities and accretion of original issue discount on a promissory note. In addition, the Fund realized a net capital loss of \$3,563,556 during the year ended December 31, 1998.

(9) NOTES PAYABLE TO BANK

The Fund has a \$100,000,000 line of credit promissory note with Bank of America N.A., with interest payable at 1/2% over the rate earned in its money market account at December 31, 2000. The Fund had \$77,000,000 and \$50,000,000 outstanding on such notes, at December 31, 2000 and 1999, respectively, that was secured by \$77,000,000 and \$50,000,000 of the Fund's temporary cash

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investments. The Fund paid \$37,500 in commitment fees in 1998, which were capitalized and amortized over the commitment period. Effective July 1, 2000, the Fund extended the line of credit promissory note to July 1, 2001.

The Fund has a \$32,500,000 revolving line of credit with Bank of America, N.A. that expires on July 1, 2001. In 1999, the Fund had a \$40,000,000 revolving line of credit with Bank of America, N.A. that expired on July 1, 2000. The Fund had \$7,300,000 and \$22,400,000 outstanding under such lines of credit at December 31, 2000 and 1999, respectively, which is secured by the Fund's investments in portfolio securities. The interest rate ranges from prime -1/2% to prime +1/4% or LIBOR + 1.65%. The Fund also pays interest at the rate of 1/4% per annum on the unused portion of the line of credit.

The average daily balances outstanding on the Fund's notes payable during the years ended December 31, 2000 and 1999, were \$18,950,064 and \$26,855,068, respectively.

(10) STOCK OPTION PLAN

Shareholders have approved the Equus II Incorporated 1997 Stock Incentive Plan ("Stock Incentive Plan"), which authorizes the Fund to issue options to the directors and officers of the Fund in an aggregate amount of up to 20% of the outstanding shares of common stock of the Fund. The Stock Incentive Plan also provides that each director who is not an officer of the Fund is, on the first business day following each annual meeting, granted an incentive stock option to purchase 2,000 shares of the Fund's common stock. On May 10, 2000, options to acquire a total of 12,000 shares at \$9.94 per share were issued to the directors. During 1999, two directors each exercised 1,000 of their options to acquire a total of 2,000 shares for \$15.5625 per share.

Under the Stock Incentive Plan, options to purchase 306,773 and 294,773 shares of the Fund's common stock with a weighted average exercise price of \$18.71 and \$19.07 per share were outstanding at December 31, 2000 and 1999, respectively. Of these options, 261,970 and 91,150 shares, with a weighted average exercise price per share of \$18.96 and \$22.33, were exercisable at December 31, 2000 and 1999, respectively. Outstanding options at December 31, 2000 have exercise prices ranging from \$9.94 to \$27.44 and expire in May 2007 through May 2010. On September 30, 1999, options to purchase 654,358 shares of common stock of the Fund were exercised by the officers of the Fund for \$17 per share. The exercise price of \$11,124,086 was paid in the form of promissory notes from the officers to the Fund. The notes bear interest at 5.42% per annum, have limited recourse and are due on or before September 30, 2008. The notes are secured by the 654,358 shares, including any proceeds or dividends paid thereon. During 2000 and 1999, a dividend of \$0.60 and \$4.25 per share was paid by the Fund, respectively. As a result of these dividends paid in 2000 and 1999, 42,723 and 135,608 additional shares, respectively, were issued to the officers and pledged to the Fund. In addition, principal payments of \$991,161, representing

58,304 shares, were made on the notes. As a result of the additional shares issued and payments made, the notes are secured by 832,689 and 789,966 shares of common stock and the outstanding balance on the notes was \$10,132,925 at December 31, 2000 and 1999, respectively.

The notes receivable, as well as 771,927 and 731,662 of such shares of pledged common stock, are not included in the Fund's reported net asset value per share at 2000 and 1999, respectively. The shares of stock financed by the notes from the officers will be included in the net asset value per share as the shares are paid for or released from collateral. The pledged shares included in the calculation of net asset value is determined based on the percentage of the officers' notes paid multiplied by the total shares pledged. Pledged shares included in the calculation of net asset value included 60,762 and 58,304 shares at December 31, 2000 and 1999, respectively. Shares may be released as payments on the notes are made or as the value of the collateral increases. Generally accepted accounting principles require that the options issued to the officers be accounted for using variable plan accounting due to the limited recourse

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provision of such notes. Additionally, the dividends paid on the common stock pledged on the non-recourse portion of the notes are required to be recorded as compensation expense in the statements of operations, and interest recorded on the non-recourse portion of the notes is required to be recorded as an increase to additional paid-in capital. Accordingly, for the year ended December 31, 2000 and 1999, dividends of \$388,663 and \$2,085,766 were recorded as non-cash compensation expense and interest of \$447,887 and \$115,217 was credited to additional paid-in capital, respectively. Additionally, the limited recourse notes receivable from the officers are required to be recorded as a reduction of net assets. If the notes and the shares were included in the Fund's balance sheet, the net asset value would have been \$15.14 and \$16.31 per share at December 31, 2000 and 1999, respectively.

As of December 31, 2000 and 1999, all outstanding options were "out of the money" and would not have had a dilutive effect on net assets per share if exercised, assuming the Fund would use the proceeds from the exercise of such options to purchase shares at the market price pursuant to the treasury stock method.

In accordance with the terms of Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees ("APB 25"), because the exercise price of the Fund's Incentive Options equals the market price of the underlying stock on the date of grant, the Fund records no compensation expense for its stock option awards. As required by the Financial Accounting Standards Board Statement No. 123, Accounting for Stock-based Compensation ("SFAS 123"), the Fund provides the following disclosure of hypothetical values for these awards. The weighted average grant-date fair value of options granted during 2000, 1999 and 1998 was \$1.71, \$1.80 and \$6.39 per share, respectively. These values for 2000, 1999 and 1998 were estimated using the Black-Scholes option-pricing model with the following weighted average assumptions: expected dividend of 6.5%, 8.4% and 4.9%, expected volatility of 26.3%, 27.6% and 28.8% and risk free interest rates of 6.8%, 6.0% and 5.8%, respectively. An expected life of 10 years was used for 2000, 1999 and 1998. Had compensation expense been recorded based on these hypothetical values, the Fund's 2000, 1999 and 1998 change in net assets from operations would have been reduced by \$551,808, \$1,146,718 and \$1,135,967, respectively. Because options vest over several years and additional grants are expected, the effects of these hypothetical calculations are not likely to be representative of similar future calculations.

(11) COMMITMENTS AND CONTINGENCIES

The Fund has made commitments to invest, under certain circumstances, up to an additional \$2,000,000 in Container Care International, Inc., \$93,500 in Equicom, Inc., \$750,000 in FS Strategies, Inc., \$625,000 in Sovereign Business Forms, Inc., \$2,100,000 in Sternhill Partners I, L.P., \$1,000,000 in Turfgrass America Inc. and \$2,400,000 in Vanguard VII, L.P. In addition, the Fund has committed to invest up to \$6,120,000 in two new companies.

The Fund and certain of the portfolio companies are involved in asserted claims and have the possibility for unasserted claims which may ultimately affect the fair value of the Fund's portfolio investments.

(12) SUBSEQUENT EVENTS

Subsequent to December 31, 2000, the Fund repaid a net \$75,600,000 of notes payable to the bank.

On February 6, 2001, the Board of Directors of the Fund authorized the repurchase of up to 5% of the outstanding common stock of the Fund, from time to time in open market transactions.

On February 7, 2001, the Fund invested an additional \$300,000 in Sternhill Partners I, L.P.

On February 9, 2001, the Fund invested \$1,116,550 in American Trenchless Technology, LLC ("American Trenchless") in exchange for 100,000 units of Series A preferred stock and 1,934,532 units of common stock. American Trenchless provides underground boring and tunneling services to its customers.

On February 9, 2001, the Fund invested \$3,686 in Reliant Window Holding, LLC ("Reliant") and received 36.86% membership interest in Reliant. In addition, the Fund committed to invest up to \$5,000,000 in Reliant under certain circumstances. Reliant was formed to invest in Reliant Building Products, Inc., which manufactures, distributes and installs aluminum and vinyl residential windows.

On February 28, 2001, the Fund sold its investment in Stephen L. LaFrance Holdings, Inc. for \$10,000,000, realizing a capital gain of \$7,501,548.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

Information about the Directors and Executive Officers of the Registrant is incorporated by reference to the Fund's Definitive Proxy Statement for the 2001 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A under the Securities and Exchange Act of 1934, as amended, prior to April 30, 2001 (the "2001 Proxy Statement").

ITEM 11. EXECUTIVE COMPENSATION.

Information regarding Executive Compensation is incorporated by reference to the Fund's 2001 Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

Information regarding Security Ownership of Certain Beneficial Owners and Management is incorporated by reference to the Fund's 2001 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

Information regarding Certain Relationships and Related Transactions is incorporated by reference to the Fund's 2001 Proxy Statement.

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) (1) FINANCIAL STATEMENTS	PAGE
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years ended December 31, 2000, 1999 and 1998	33
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All other information required in the financial statement schedules has been incorporated in the financial statements or notes thereto or has been omitted since the information is not applicable, not present or not present in amounts sufficient to require submission of the schedule.

(a) (3) EXHIBITS

3. Articles of Incorporation and by-laws

- (a) Restated Certificate of Incorporation of the Fund dated March 4, 1992. [Incorporated by reference to Exhibit 3(a) to Registrant's Annual Report on Form 10-K for the year ended December 31, 1991]
- (b) Certificate of Merger dated June 30, 1993, between the Fund and Equus Investments Incorporated [Incorporated by reference to Exhibit 3(c) to Registrant's Annual Report on Form 10-K for the year ended December 31, 1993]
- (c) Amended and Restated Bylaws of the Fund. [Incorporated by reference to Exhibit 3(c) to Registrant's Annual Report on Form 10-K for the year ended December 31, 1995]

10. Material Contracts

- (a) Form of Management Agreement between the Fund and Equus Capital Management Corporation. [Incorporated by reference to Exhibit A to the Definitive Proxy Statement dated February 24, 1997]
- (b) 1997 Stock Incentive Plan [Incorporated by reference to Exhibit B to the Registrant's Definitive Proxy Statement dated February 24, 1997]
- (c) Amended and Restated Loan Agreement by and between Equus II Incorporated and NationsBank of Texas, N.A., dated March 29, 1996 [Incorporated by reference to Exhibit 10(g) to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1996.]
- (d) Second Amendment and Restated Loan Agreement by and between Equus II Incorporated and Nations Bank, N.A., d/b/a Bank of America, N.A. dated June 1, 1999. [Incorporated by reference to Exhibit 10 to Registrant's Quarterly Report on form 10-Q for the quarter ended June 30, 1999.]
- (e) Form of promissory note and security agreement-pledge dated September 30, 1999. [Incorporated by reference to Exhibit 10 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1999.]

(b) REPORTS ON FORM 8-K

No reports on Form 8-K were filed by the Fund during the last quarter of the period covered by this report.

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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 II INCORPORATED

/s/ NOLAN LEHMANN

Date: March 2, 2001 Nolan Lehmann, President

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/ GREGORY J. FLANAGAN (Gregory J. Flanagan)	Director	March 2, 2001
/s/ ROBERT L. KNAUSS (Robert L. Knauss)	Director	March 2, 2001
/s/ GARY R. PETERSEN (Gary R. Petersen)	Director	March 2, 2001
/s/ JOHN W. STORMS (John W. Storms)	Director	March 2, 2001
/s/ FRANCIS D. TUGGLE (Francis D. Tuggle)	Director	March 2, 2001
/s/ EDWARD E. WILLIAMS (Edward E. Williams)	Director	March 2, 2001
/s/ NOLAN LEHMANN (Nolan Lehmann)	President and Director (principal financial and accounting officer)	March 2, 2001

/s/ SAM P. DOUGLASS
(Sam P. Douglass)

Chairman of the Board and Chief
Executive Officer (principal
executive officer)

March 2, 2001

