

# CAPITAL SOUTHWEST CORP

## FORM 10-K (Annual Report)

Filed 05/23/08 for the Period Ending 03/31/08

|             |  |
|-------------|--|
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| CIK         | 0000017313                                   |
| Symbol      | CSWC   |
| Industry    | Misc. Financial Services                     |
| Sector      | Financial                                    |
| Fiscal Year | 03/31  |

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

**FORM 10-K**

(Mark One)

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

For the fiscal year ended March 31, 2008

OR

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

For the transition period from to

*Commission File Number: 814-61*

**CAPITAL SOUTHWEST CORPORATION**

(Exact name of registrant as specified in its charter)

Texas  
(State or other jurisdiction of incorporation  
or organization)

75-1072796  
(I.R.S. Employer  
Identification No.)

12900 Preston Road, Suite 700, Dallas, Texas  
(Address of principal executive offices)

75230  
(Zip Code)

Registrant's telephone number, including area code: (972) 233-8242

**Securities registered pursuant to section 12(b) of the Act: None**

Securities registered pursuant to section 12(g) of the Act: Common Stock, \$1.00  
par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes [ ] No [X]

The aggregate market value of the voting stock held by non-affiliates of the registrant as of September 30, 2007 was \$314,927,409, based on the last sale price of such stock as quoted by Nasdaq on such date.

The number of shares of common stock outstanding as of May 1, 2008 was 3,889,151.

Documents Incorporated by Reference

Part of Form 10-K

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Proxy Statement for Annual Meeting of Shareholders  
to be held July 21, 2008

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Part III

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## PART I

### Item 1. Business

We were organized as a Texas corporation on April 19, 1961. Until September 1969, we operated as a licensee under the Small Business Investment Act of 1958. At that time, we transferred to our wholly-owned subsidiary, Capital Southwest Venture Corporation ("CSVC"), certain assets and our license as a small business investment company ("SBIC"). CSVC is a closed-end, non-diversified investment company of the management type registered under the Investment Company Act of 1940 (the "1940 Act"). Prior to March 30, 1988, we were registered as a closed-end, non-diversified investment company under the 1940 Act. On that date, we elected to become a business development company subject to the provisions of the 1940 Act, as amended by the Small Business Incentive Act of 1980. Because we wholly own CSVC, the portfolios of both entities are referred to collectively as "our," "we" and "us."

We are a venture capital investment company whose objective is to achieve capital appreciation through long-term investments in businesses believed to have favorable growth potential. Our investment interests are focused on expansion financings, management buyouts, recapitalizations, industry consolidations and early-stage financings in a broad range of industry segments. Our portfolio is a composite of companies in which we have major interests as well as a number of developing companies and marketable securities of established publicly-owned companies. We make available significant managerial assistance to the companies in which we invest and believe that providing material assistance to such investee companies is critical to their business development activities.

The 12 largest investments we own had a combined cost of \$43,523,388 and a value of \$499,866,033, representing 91.3% of the value of our consolidated investment portfolio at March 31, 2008. For a narrative description of the 12 largest investments, see "Twelve Largest Investments - March 31, 2008" in Exhibit 13.1 of this Form 10-K which is herein incorporated by reference. Certain of the information presented on the 12 largest investments has been obtained from the respective companies and, in certain cases, from public filings of such companies. The financial information presented on each of the respective companies is from such companies' audited financial statements.

We compete for attractive investment opportunities with private equity funds, venture capital partnerships and corporations, venture capital affiliates of industrial and financial companies, SBICs and wealthy individuals.

The number of persons employed by us at March 31, 2008 was seven.

Our internet website address is [www.capitalsouthwest.com](http://www.capitalsouthwest.com). You can review the filings we have made with the U.S. Securities and Exchange Commission, free of charge by linking directly from our website to NASDAQ, a database that links to EDGAR, the Electronic Data Gathering, Analysis, and Retrieval System of the SEC. You should be able to access our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. The charters adopted by the committees of our board of directors are also available on our website.

### Item 1A. Risk Factors

You should carefully consider the risks described below and all other information contained in this annual report on Form 10-K, including our consolidated financial statements and the related notes thereto. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties not presently known to us, or not presently deemed material by us, may also impair our operations and performance. If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. If that happens, the trading price of our common stock could decline, and you may lose all or part of your investment.

There is uncertainty regarding the value of our investments in restricted securities.

Our net asset value is based on the values assigned to the various investments in our portfolio, determined in good faith by our board of directors. Because of the inherent uncertainty of the valuation of portfolio securities which do not have readily ascertainable market values, our fair value determinations may differ materially from the values a third party would be willing to pay for such securities or the values which would be applicable to unrestricted securities having a public market.

We are subject to additional risks in light of the restatement of our prior period consolidated financial statements.

We have restated our consolidated financial statements for the year ended March 31, 2007 and all years represented in our Form 10-K for the year ended March 31, 2007 due to material weakness we identified in our internal controls over accounting for taxes. The restatement of our consolidated financial statements could expose us to legal actions. The defense of any such actions could cause the diversion of management's attention and resources, and we could be required to pay damages to settle such actions if any such actions are not resolved in our favor. Even if resolved in our favor, such actions could cause us to incur significant legal and other expenses. Moreover, we may be the subject of negative publicity focusing on the restatement and negative reactions from shareholders and others with whom we do business.

The lack of liquidity of our restricted securities may adversely affect our business.

Our portfolio contains many securities which are subject to restrictions on sale because they were acquired from issuers in "private placement" transactions or because we are deemed to be an affiliate of the issuer. Unless an exemption from the registration requirements of the Securities Act of 1933 is available, we will not be able to sell these securities publicly without the expense and time required to register the securities under applicable federal and state securities laws. In addition, contractual or practical limitations may restrict our ability to liquidate our securities in portfolio companies, because we may own a relatively large percentage of the issuer's outstanding securities. Sales may also be limited by unfavorable market conditions. The illiquidity of our investments may preclude or delay the disposition of such securities, which may make it difficult for us to obtain cash equal to the value at which we record our investments.

There is limited publicly available information regarding the companies in which we invest.

Many of the securities in our portfolio are issued by privately held companies. There is generally little or no publicly available information about such companies, and we must rely on the diligence of our management to obtain the information necessary for our decision to invest. There can be no assurance that such diligence efforts will uncover all material information necessary to make fully informed investment decisions.

Certain of our portfolio companies are highly leveraged.

Many of our portfolio companies have incurred substantial indebtedness in relation to their overall capital base. Such indebtedness often has a term that will require the balance of the loan to be refinanced when it matures. If portfolio companies cannot generate adequate cash flow to meet the principal and interest payments on their indebtedness, the value of our investments could be reduced or eliminated through foreclosure on the portfolio company's assets or by the portfolio company's reorganization or bankruptcy.

Fluctuations may occur in our quarterly results.

Our quarterly operating results may fluctuate materially due to a number of factors including, among others, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our portfolio companies' markets, the ability to find and close suitable investments, and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

We may not continue to qualify for pass-through tax treatment.

We may not qualify for conduit tax treatment as a Regulated Investment Company ("RIC") if we are unable to comply with the requirements of Subchapter M of the Internal Revenue Code. If we fail to satisfy such requirements and cease to qualify for conduit tax treatment, we will be subject to federal taxes on our net investment income. To the extent we had unrealized gains, we would have to establish reserves for taxes, which would reduce our net asset value accordingly. In addition, if we, as a RIC, were to decide to make a deemed distribution of net realized capital gains and retain the net realized capital gain, we would have to establish appropriate reserves for taxes, at the end of the tax year, that we would have to pay on behalf of our shareholders. The loss of this pass-through tax treatment could have a material adverse effect on the total return, if any, obtainable from an investment in our common stock.

Historically, we have distributed net investment income semi-annually. Our current intention is to continue these distributions of ordinary income to our shareholders. Also, historically, we have retained net realized capital gains, paid the resulting tax at the corporate level and retained the after-tax gains to supplement our equity capital and support continuing additions to our portfolio. Our shareholders then report such capital gains on their tax returns, receive credit for the tax we paid and are deemed to have reinvested the amount of the retained after-tax gain. We cannot assure you that we will achieve investment results or maintain a RIC tax status that will allow any specified level of cash distributions or our shareholders' current tax treatment of realized and retained capital gains.

Investment in shares of our common stock should not be considered a complete investment program.

Our stock is intended for investors seeking long-term capital appreciation. Our investments in portfolio securities generally require many years to reach maturity, and such investments generally are illiquid. An investment in our shares should not be considered a complete investment program. Each prospective purchaser should take into account his or her investment objectives as well as his or her other investments when considering the purchase of our shares.

Our common stock often trades at a discount from net asset value.

Our common stock is listed on The Nasdaq Global Market ("NASDAQ"). Shareholders desiring liquidity may sell their shares on NASDAQ at current market value, which has often been below net asset value. Shares of closed-end investment companies frequently trade at discounts from net asset value, which is a risk separate and distinct from the risk that a fund's performance will cause its net asset value to decrease.

Our financial condition and results of operations will depend on our ability to effectively manage any future growth.

Sustaining growth depends on our ability to identify, evaluate, finance, and invest in companies that meet our investment criteria. Accomplishing such results on a cost-effective basis is a function of our marketing capabilities and skillful management of the investment process. Failure to achieve future growth could have a material adverse effect on our business, financial condition, and results of operations.

We are dependent upon management for our future success.

Selection, structuring and closing our investments depends upon the diligence and skill of our management, which is responsible for identifying, evaluating, negotiating, monitoring and disposing of our investments. Our management's capabilities may significantly impact our results of operations. If we lose any member of our management team and he/she cannot be promptly replaced with an equally capable team member, our results of operations could be significantly impacted.

We operate in a highly competitive market for investment opportunities.

We compete for attractive investment opportunities with private equity funds, venture capital partnerships and corporations, venture capital affiliates of industrial and financial companies, SBICs and wealthy individuals. Some of these competitors are substantially larger and have greater financial resources,

and some are subject to different and frequently less stringent regulation. As a result of this competition, we may not be able to take advantage of attractive investment opportunities from time to time and there can be no assurance that we will be able to identify and make investments that satisfy our objectives.

Changes in laws or regulations governing our operations or our failure to comply with those laws or regulations may adversely affect our business.

We and our portfolio companies are subject to regulation by laws at the local, state and federal level. These laws and regulations, as well as their interpretation, may be changed from time to time. Accordingly, any changes in these laws and regulations or failure to comply with them could have a material adverse effect on our business. Certain of these laws and regulations pertain specifically to business development companies such as ours.

Failure to deploy new capital may reduce our return on equity.

If we fail to invest our capital effectively, our return on equity may be decreased, which could reduce the price of the shares of our common stock.

The market price of our common stock may fluctuate significantly.

The market price and marketability of shares of our common stock may from time to time be significantly affected by numerous factors, including our investment results, market conditions, and other influences and events over which we have no control and that may not be directly related to us.

### **Item 1B. Unresolved Staff Comments**

We have no unresolved staff comments to report pursuant to Item 1B.

### **Item 2. Properties**

We maintain our offices at 12900 Preston Road, Suite 700, Dallas, Texas, 75230, where we rent approximately 4,232 square feet of office space pursuant to a lease agreement expiring in February 2013. We believe that our offices are adequate to meet our current and expected future needs.

### **Item 3. Legal Proceedings**

We are currently the subject of certain legal actions. In our judgment, none of the lawsuits currently pending against us, either individually or in the aggregate, is likely to have a material adverse effect on our business, results of operations, or financial position.

We, Capital Southwest Corporation and CSVC, have been named in a lawsuit filed on August 27, 2007 in the United States District Court of the Northern District of Texas, Dallas Division, against Heelys, Inc and their Chief Executive Officer, Chief Financial Officer, the directors who signed their registration statement with the Securities and Exchange Commission in connection with their December 7, 2006 initial public offering ("IPO"), and their underwriters for the IPO. The complaint alleges violations of Sections 11 and 15 of the Securities Act of 1933 and the plaintiffs are seeking compensatory damages in an unspecified amount, as well as reasonable costs and expenses incurred in the action, including counsel fees and expert fees.

Similar suits were also filed in 2007 and 2008 in the United States District Court of the Northern District of Texas making substantially similar allegations under Sections 11, 12 and 15 of the Securities Act of 1933, and seeking substantially similar damages. These lawsuits have been transferred to a single judge, and we expect that all the cases will be consolidated into a single action, with a consolidated complaint filed shortly thereafter.

We believe that the plaintiffs' claims are without merit, we deny the allegations in the complaints, and we intend to vigorously defend the lawsuits.

Additionally, we, Capital Southwest Corporation, have been named in a lawsuit filed on April 10, 2008 in the 193rd Judicial District Court, Dallas County, Texas. ZS Crossover II, L.P., ZS Special I, L.P. and Warlen L.P. (the "petitioners") filed the action to compel us to produce for inspection and copying certain records of the Company, primarily its shareholder list. The petitioners are not seeking an award in damages from the Company, but are seeking an unspecified amount of legal fees and expenses.

#### **Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of security holders during the quarter ended March 31, 2008.

## **PART II**

#### **Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Information set forth under the captions "Shareholder Information - Shareholders, Market Prices and Dividends" in Exhibit 13.1 of this Form 10-K is herein incorporated by reference.

#### **Performance Graph**

The following graph compares our cumulative total shareholder return during the last five years (based on the market price of our common stock and assuming reinvestment of all dividends and tax credits on retained long-term capital gains) with the Total Return Index for NASDAQ (U.S. companies) and with the Total Return Index for Nasdaq Financial Stocks, both of which indices have been prepared by the Center for Research in Security Prices at the University of Chicago.

#### **Comparison of Five Year Cumulative Total Returns**

**[GRAPH OMITTED]**

|      | Nasdaq Total<br>Return (U.S.) | Nasdaq Financial<br>Stocks | Capital Southwest<br>Corporation |
|------|-------------------------------|----------------------------|----------------------------------|
| 2003 | 100.000                       | 100.000                    | 100.000                          |
| 2004 | 147.600                       | 143.777                    | 167.559                          |
| 2005 | 148.586                       | 149.552                    | 172.435                          |
| 2006 | 175.219                       | 175.695                    | 210.125                          |
| 2007 | 181.752                       | 183.907                    | 344.239                          |
| 2008 | 169.511                       | 155.262                    | 275.615                          |

#### **Item 6. Selected Financial Data**

See Exhibit 13.1 "Selected Consolidated Financial Data" of this Form 10-K.

#### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

See Exhibit 13.1 "Selected Consolidated Financial Data" of this Form 10-K.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

We are subject to financial market risks, including changes in marketable equity security prices. We do not use derivative financial instruments to mitigate any of these risks.

Our investment performance is a function of our portfolio companies' profitability, which may be affected by economic cycles, competitive forces, foreign currency fluctuations and production costs including labor rates, raw material prices and certain basic commodity prices. Most of the companies in our investment portfolio do not hedge their exposure to raw material and commodity price fluctuations. However, the portfolio company with the greatest exposure to foreign currency fluctuations generally hedges its exposure. All of these factors may have an adverse effect on the value of our investments and on our net asset value.

Our investment in portfolio securities includes fixed-rate debt securities which totaled \$9,000,000 at March 31, 2008, equivalent to 1.6% of the value of our total investments. Generally, these debt securities are below investment grade and have relatively high fixed rates of interest, therefore, minor changes in market yields of publicly-traded debt securities have little or no effect on the values of debt securities in our portfolio and no effect on interest income. Our investments in 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.

A portion of our investment portfolio consists of debt and equity securities of private companies. We anticipate little or no effect on the values of these investments from modest changes in public market equity valuations. Should significant changes in market valuations of comparable publicly-owned companies occur, there may be a corresponding effect on valuations of private companies, which would affect the value and the amount and timing of proceeds eventually realized from these investments. A portion of our investment portfolio also consists of restricted common stocks of publicly-owned companies. The fair values of these restricted securities are influenced by the nature of applicable resale restrictions, the underlying earnings and financial condition of the issuers of such restricted securities and the market valuations of comparable publicly-owned companies. A portion of our investment portfolio also consists of unrestricted, freely marketable common stocks of publicly-owned companies. These freely marketable investments, which are valued at the public market price, are directly exposed to equity price risks, in that a change in an issuer's public market equity price would result in an identical change in the value of our investment in such security.

Item 8. Financial Statements and Supplementary Data

See Item 15 of this Form 10-K - "Exhibits and Financial Statement Schedules."

Selected Quarterly Financial Data (Unaudited)

The following presents a summary of the unaudited quarterly consolidated financial information for the years ended March 31, 2008 and 2007.

|   | First<br>Quarter                         | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter | Total     |
|---|--|-------------------|------------------|-------------------|-----------|
|   | -----                                    | -----             | -----            | -----             | -----     |
|   | (In thousands, except per share amounts) |                   |                  |                   |           |
| 2008  |  |                   |                  |                   |           |
| ----  |  |                   |                  |                   |           |
| Net investment income   | \$ 641                                   | \$ 1,211          | \$ 1,806         | \$ 57             | \$ 3,715  |
| Net realized gain (loss) on investment                            | 326                                      | 403               | (489)            | --                | 240       |
| Net increase (decrease) in unrealized appreciation of investments | 17,148                                   | (138,129)         | (64,798)         | 42,809            | (142,970) |
| Net increase (decrease) in net assets from operations             | 18,115                                   | (136,515)         | (63,481)         | 42,866            | (139,015) |
| Net increase (decrease) in net assets from operations per share   | 4.66                                     | (35.10)           | (16.32)          | 11.02             | (35.74)   |

|   | First<br>Quarter<br>-----                | Second<br>Quarter<br>----- | Third<br>Quarter<br>----- | Fourth<br>Quarter<br>----- | Total<br>----- |
|---|--|----------------------------|---------------------------|----------------------------|----------------|
| 2007  |  |                            |                           |                            |                |
| -----   |  |                            |                           |                            |                |
|   | (In thousands, except per share amounts) |                            |                           |                            |                |
| Net investment income   | \$ 492                                   | \$ 1,170                   | \$ 1,617                  | \$ 954                     | \$ 4,233       |
| Net realized gain (loss) on investment                            | 397                                      | 9,219                      | 19,531                    | (14,181)                   | 14,966         |
| Net increase (decrease) in unrealized appreciation of investments | (5,218)                                  | (2,931)                    | 132,210                   | 23,621                     | 147,682        |
| Net increase (decrease) in net assets from operations             | (4,329)                                  | 7,458                      | 153,358                   | 10,394                     | 166,881        |
| Net increase (decrease) in net assets from operations per share   | (1.12)                                   | 1.92                       | 39.46                     | 2.66                       | 42.94          |

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

None.

### Item 9A. Controls and Procedures

#### (i) Disclosure Controls and Procedures.

As of March 31, 2008, an evaluation was performed under the supervision and with the participation of our management, including the President and Controller, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15 (e) and 15d-15(e) of the Securities Exchange Act of 1934 (the "1934 Act")). Disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the 1934 Act is recorded, processed, summarized and reported, within time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the issuer's management, as appropriate, to allow timely decisions regarding required disclosures. As of March 31, 2008, based on this evaluation of our disclosure controls and procedures, our President and Controller concluded that our disclosure controls and procedures were effective as of March 31, 2008.

During the fiscal quarter ended March 31, 2008, the Company implemented the following control in order to remediate the material weakness we identified in our internal controls over accounting for taxes, which resulted in the restatement of our consolidated financial statements for the year ended March 31, 2007 and years represented in our Form 10-K for the year ended March 31, 2007.

o On a quarterly basis the Company will consult with a RIC compliance expert, on our current RIC status and the potential impact of proposed transactions and scenarios on the Company's future RIC compliance status. The Company has engaged KPMG, LLP in this capacity.

There were no other changes to our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

#### (ii) Internal Control Over Financial Reporting.

(a) Management's annual report on internal control over financial reporting.

The Company's management report on internal control over financial reporting is set forth in our 2008 Annual Report and is incorporated herein by reference.

(b) Attestation report of the registered public accounting firm

Our independent registered public accountants, Grant Thornton LLP, audited the consolidated financial statements and have issued an attestation report on the effectiveness of our internal control over financial reporting as of March 31, 2008, which is set forth in our 2008 Annual Report and is incorporated herein by reference.

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

There have been no significant changes in our internal controls over financial reporting or in other factors that could significantly affect the internal controls over financial reporting during the year ended March 31, 2008.

### **PART III**

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

The section of our 2008 Proxy Statement captioned "Nominees for Director" under "Proposal 1. Election of Directors" identifies members of our board of directors and nominees, and is incorporated in this Item 10 by reference.

The names and ages of our executive officers as of June 2, 2008, together with certain biographical information, are as follows:

William M. Ashbaugh, age 53, has served as Senior Vice President since 2005 and Vice President since 2001. He previously served as Managing Director in the corporate finance departments of Hoak Breedlove Wesneski & Co. from 1998 to 2001, Principal Financial Securities from 1997 to 1998 and Southwest Securities from 1995 to 1997.

Gary L. Martin, age 61, was named President and Chief Executive Officer in July 2007, has been a director since July 1988 and has served as Vice President since 1984. He previously served as Vice President from 1978 to 1980. Since 1980, Mr. Martin has served as President of The Whitmore Manufacturing Company, a wholly-owned portfolio company.

Jeffrey G. Peterson, age 34, was named Secretary and Compliance Officer in August 2007, has served as Vice President since 2005 and was an Investment Associate since 2001. He previously held positions with the investment banking division of Scott & Stringfellow, Inc. and the corporate lending division of Bank One.

The sections of our 2008 Proxy Statement captioned "Meetings and Committees of the Board of Directors under "Proposal 1. Election of Directors" and "Report of the Audit Committee" identifies members of our audit committee of our board of directors and our audit committee financial expert, and are incorporated in this Item 10 by reference.

The section of our 2008 Proxy Statement captioned "Section 16(a) Beneficial Ownership Reporting Compliance" is incorporated in this Item 10 by reference.

#### **Code of Ethics**

We have adopted a code of ethics that applies to all our directors, officers and employees. We have made the Code of Conduct and Ethics available on our website at [www.capitalsouthwest.com](http://www.capitalsouthwest.com). Shareholders may request a free copy of the Code of Conduct and Ethics from: Jeffrey G. Peterson, Corporate Secretary.

Item 11. Executive Compensation

The information in the section of our 2008 Proxy Statement captioned "Compensation Discussion and Analysis" is incorporated in this Item 11 by reference.

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

The information in the sections of our 2008 Proxy Statement captioned "Stock Ownership of Certain Beneficial Owners" are incorporated in this Item 12 by reference.

The table below sets forth certain information as of March 31, 2008 regarding the shares of our common stock available for grant or granted under stock option plans that (i) were approved by our shareholders, and (ii) were not approved by our shareholders.

Equity Compensation Plan Information

| Plan Category  | Number of Securities To Be Issued Upon Exercise of Outstanding Options, Warrants And Rights | Weighted-Average Exercise Price Of Outstanding Options, Warrants And Rights | Number of Securities Remaining Available For Future Issuance Under Equity Compensation Plans |
|--|---|---|--|
| Equity compensation plans approved by security holders(1)  | 70,400  | \$109.998   | 37,500   |
| Equity compensation plans not approved by security holders | --  | --  | --   |
| Total  | 70,400  | \$109.998   | 37,500   |

(1) Includes the 1999 Stock Option Plan. For a description of this plan, please refer to Footnote 5 contained in our consolidated financial statements.

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

The information in the sections of our 2008 Proxy Statement captioned "Meetings and Committees of the Board of Directors" - "Committee Member Independence" and "Certain Relationships and Related Party Transactions" are incorporated in this Item 13 by reference.

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

The information in the sections of our 2008 Proxy Statement captioned "Proposal 2: Ratification of Appointment of Independent Registered Accounting Firm" and "Audit and Other Fees" are incorporated in this Item 14 by reference.

**PART IV**

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

(a)(1) The following information included in Exhibit 13.1 is herein incorporated by reference:

(A) Portfolio of Investments - March 31, 2008

Consolidated Statements of Financial Condition - March 31, 2008 and 2007

Consolidated Statements of Operations - Years Ended March 31, 2008, 2007 and 2006

Consolidated Statements of Changes in Net Assets - Years Ended March 31, 2008, 2007 and 2006

Consolidated Statements of Cash Flows - Years Ended March 31, 2008, 2007 and 2006

(B) Notes to Consolidated Financial Statements

(C) Notes to Portfolio of Investments

(D) Selected Per Share Data and Ratios

(E) Management's Report on Internal Control over Financial Reporting

(F) Reports of Independent Registered Public Accounting Firm

(G) Portfolio Changes During the Year

(a)(2) All schedules are omitted because they are not applicable or not required, or the information is otherwise supplied.

(a)(3) See the Exhibit Index.

## SIGNATURES

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

### CAPITAL SOUTHWEST CORPORATION

By: /s/ Gary L. Martin  
-----  
Gary L. Martin, President

Date: May 23, 2008

### POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS that each of Capital Southwest Corporation and its Subsidiaries undersigned directors hereby constitutes and appoints Gary L. Martin, its or his true and lawful attorney-in-fact and agent, for it or him and in its or his name, place and stead, in any and all capacities, with full power to act alone, to sign any and all amendments to this Report, and to file each such amendment to the Report, with all exhibits thereto, and any and all other documents in connection therewith, with the Securities and Exchange Commission, hereby granting unto said attorney-in-fact and agent full power and authority to do and perform any and all acts and things requisite and necessary to be done in and about the premises as fully to all intents and purposes as it or he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirement of the Securities and 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:

| <i>Signature</i><br>-----                               | <i>Title</i><br>-----                  | <i>Date</i><br>----- |
|---|--|----------------------|
| /s/ Gary L. Martin<br>-----<br>Gary L. Martin           | President<br>(chief executive officer) | May 23, 2008         |
| /s/ William R. Thomas<br>-----<br>William R. Thomas     | Chairman of the Board                  | May 23, 2008         |
| /s/ Donald W. Burton<br>-----<br>Donald W. Burton       | Director                               | May 23, 2008         |
| /s/ Graeme W. Henderson<br>-----<br>Graeme W. Henderson | Director                               | May 23, 2008         |
| /s/ Samuel B. Ligon<br>-----<br>Samuel B. Ligon         | Director                               | May 23, 2008         |
| /s/ Gary L. Martin<br>-----<br>Gary L. Martin           | Director                               | May 23, 2008         |
| /s/ John H. Wilson<br>-----<br>John H. Wilson           | Director                               | May 23, 2008         |
| /s/ Tracy L. Morris<br>-----                            | Controller                             | May 23, 2008         |

----- (chief financial/accounting officer) Tracy L. Morris

## EXHIBIT INDEX

The following exhibits are filed with this report or are incorporated herein by reference to a prior filing, in accordance with Rule 12b-32 under the Securities Exchange Act of 1934. Asterisk denotes exhibits filed with this report. Double asterick denotes exhibits furnished with this report.

| Exhibit No.<br>----- | Description<br>-----   |
|----------------------|--|
| 3.1(a)               | Articles of Incorporation and Articles of Amendment to Articles of Incorporation, dated June 25, 1969 (filed as Exhibit 1(a) and 1(b) to Amendment No. 3 to Form N-2 for the fiscal year ended March 31, 1979).  |
| 3.1(b)               | Articles of Amendment to Articles of Incorporation, dated July 20, 1987 (filed as an exhibit to Form N-SAR for the six month period ended September 30, 1987).   |
| 3.2                  | By-Laws of the Company, as amended.  |
| 4.1                  | Specimen of Common Stock certificate (filed as Exhibit 4.1 to Form 10-K for the fiscal year ended March 31, 2002).   |
| 10.1                 | The RectorSeal Corporation and Jet-Lube, Inc. Employee Stock Ownership Plan as revised and restated effective April 1, 2007.   |
| 10.2                 | Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates as amended and restated effective April 1, 2006.   |
| 10.3                 | Capital Southwest Corporation and Its Affiliates Restoration of Retirement Income Plan for certain highly-compensated superseded plan participants effective April 1, 1993 (filed as Exhibit 10.4 to Form 10-K for the fiscal year ended March 31, 1995).                  |
| 10.4                 | Amendment One to Capital Southwest Corporation and Its Affiliates Restoration of Retirement Income Plan for certain highly-compensated superceded plan participants effective April 1, 1993 (filed as Exhibit 10.6 to Form 10-K for the fiscal year ended March 31, 1998). |
| 10.5                 | Capital Southwest Corporation Retirement Income Restoration Plan as amended and restated effective April 1, 1989 (filed as Exhibit 10.5 to Form 10-K for the fiscal year ended March 31, 1995).  |
| 10.6                 | Form of Indemnification Agreement which has been established with all directors and executive officers of the Company (filed as Exhibit 10.9 to Form 8-K dated February 10, 1994).   |
| 10.7                 | Capital Southwest Corporation 1999 Stock Option Plan (filed as Exhibit 10.10 to Form 10-K for the fiscal year ended March 31, 2000).   |
| 10.8                 | Severance Pay Agreement with William M. Ashbaugh (filed as Exhibit 10.1 to Form 8-K dated July 18, 2005).  |
| 10.10                | Severance Pay Agreement with Jeffrey G. Peterson (filed as Exhibit 10.4 to Form 8-K dated July 18, 2005).  |
| 10.11*               | Amendment One to Retirement Plan for Employees of Capital Southwest Corporation and its Affiliates as amended and restated effective April 1, 2006.  |

- 13.1\* Selected Consolidated Financial Data.
- 21.1\* List of subsidiaries of the Company.
- 23.1\* Consent of Independent Registered Public Accounting Firm - Grant Thornton LLP.
- 31.1\* Certification of President required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), filed herewith.
- 31.2\* Certification of Controller required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act, filed herewith.
- 32.1\*\* Certification of President required by Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code, furnished herewith.
- 32.2\*\* Certification of Controller required by Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code, furnished herewith.

**Exhibit 10.11**

**AMENDMENT ONE TO**  
**RETIREMENT PLAN FOR EMPLOYEES OF**  
**CAPITAL SOUTHWEST CORPORATION AND ITS AFFILIATES**  
**As Amended and Restated Effective April 1, 2006**

WHEREAS, effective as of April 1, 2006, the Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates (the "Plan") was amended and restated in its entirety;

WHEREAS, by the terms of Section 6.4 of the Plan, the Plan may be amended; and

WHEREAS, it is necessary that a technical amendment be made to the Plan in order to obtain approval of the Internal Revenue Service for the continued qualification of the Plan;

NOW, THEREFORE, the Plan is hereby amended, effective as set forth below, as follows:

1. Effective as of April 1, 2002, clause (b) in the last paragraph of Section 4.6(A) of the Plan is amended to read in its entirety as follows:

"(b) the aggregate distributions made on his behalf during the one-year period ending on the Determination Date (five-year period ending on the Determination Date, with respect to any distribution made for any reason other than death, disability, or severance of employment);"

2. Effective as of April 1, 2004, Section 4.1(A)(2) of the Plan is amended to add the following paragraph at the end thereof:

"Notwithstanding the foregoing provisions of this Section 4.1(A)(2), for Plan Years beginning in 2004 and 2005 the interest rate of 5.5% shall be substituted for the annual rate of interest on 30-year Treasury securities for purposes of this Section 4.1(A), except that in the case of any Participant or Beneficiary receiving a distribution after December 31, 2003 and before January 1, 2005, the amount payable under any form of benefit subject to Section 417(e)(3) of the Internal Revenue Code and subject to adjustment under Section 415(b)(2)(B) of the Internal Revenue Code shall not, solely by reason of the interest rate substitution described above, be less than the amount that would have been so payable had the amount payable been determined using the annual rate of interest on 30-year Treasury securities described above in this Section 4.1(A)(2) in effect as of the last day of the last Plan Year beginning before January 1, 2004."

IN WITNESS WHEREOF, CAPITAL SOUTHWEST CORPORATION has caused this instrument to be executed by its duly authorized officer on this \_\_\_\_ day of \_\_\_\_\_, 2008.

**CAPITAL SOUTHWEST CORPORATION**

By \_\_\_\_\_

Title: \_\_\_\_\_

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**The RectorSeal Corporation \$144,200,000**

The RectorSeal Corporation, Houston, Texas, with facilities in Texas, New York and Idaho, manufactures specialty chemical products including pipe thread sealants, firestop sealants, plastic cements and other formulations for plumbing, HVAC, electrical and industrial applications. The company also makes special tools for plumbers and systems for containing smoke from building fires. RectorSeal's subsidiary, Jet-Lube, Inc., with plants in Texas, England and Canada, produces anti-seize compounds, specialty lubricants and other products used in industrial and oil field applications. Another subsidiary produces and sells automotive chemical products. RectorSeal also owns a 20% equity interest in The Whitmore Manufacturing Company (described on page 9).

During the year ended March 31, 2008, RectorSeal earned \$11,264,000 on revenues of \$112,029,000, compared with earnings of \$9,676,000 on revenues of \$103,922,000 in the previous year. RectorSeal's earnings do not reflect its 20% equity in The Whitmore Manufacturing Company.

At March 31, 2008, Capital Southwest owned 100% of RectorSeal's common stock having a cost of \$52,600 and a value of \$144,200,000.

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**Lifemark Group \$71,000,000**

Lifemark Group, Hayward, California, owns and operates cemeteries, funeral homes, mausoleums and mortuaries. Lifemark's operations, all of which are in California, include a major cemetery and funeral home in San Mateo, a mausoleum and an adjacent mortuary in Oakland and cemeteries, mausoleums and mortuaries in Hayward and Sacramento. The company also owns a funeral home in San Bruno. Its funeral and cemetery trusts enable Lifemark's clients to make pre-need arrangements. The company's assets also include excess real estate holdings.

For the fiscal year ended March 31, 2008, Lifemark reported earnings of \$529,000 on revenues of \$29,682,000, compared with earnings of \$2,239,000 on revenues of \$28,727,000 in the previous year.

At March 31, 2008, Capital Southwest owned 100% of Lifemark Group's common stock, which had a cost of \$4,510,400 and was valued at \$71,000,000.

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**Encore Wire Corporation \$51,084,375**

Encore Wire Corporation, McKinney, Texas, manufactures a broad line of copper electrical building wire and cable including non-metallic sheathed, underground feeder and THHN wire and cable as well as armored cable for residential, commercial and industrial construction. Encore's products are sold through distributors and building materials retailers.

For the year ended December 31, 2007, Encore reported net income of \$30,796,000 (\$1.32 per share) on net sales of \$1,184,786,000, compared with net income of \$115,133,000 (\$4.86 per share) on net sales of \$1,249,330,000 in the previous year. The March 31, 2008 closing Nasdaq bid price of Encore's common stock was \$18.18 per share.

At March 31, 2008, the \$5,800,000 investment in 4,086,750 shares of Encore's restricted common stock by Capital Southwest and its subsidiary was valued at \$51,084,375 (\$12.50 per share), representing a fully-diluted equity interest of 16.9%.

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**Alamo Group Inc. \$45,284,800**

Alamo Group Inc., Seguin, Texas, is a leading designer, manufacturer and distributor of heavy-duty, tractor and truck mounted mowing and other vegetation maintenance equipment, mobile excavators, street-sweeping and snow removal equipment and replacement parts. Founded in 1969, Alamo Group operates 16 manufacturing facilities and serves governmental, industrial and agricultural markets in North America, Europe, and Australia.

For the year ended December 31, 2007, Alamo reported net income of \$12,365,000 (\$1.24 per share) on net sales of \$504,386,000, compared with net income of \$11,488,000 (\$1.16 per share) on net sales of \$456,494,000 in the previous year. The March 31, 2008 closing NYSE market price of Alamo's common stock was \$21.27 per share.

At March 31, 2008, the \$2,190,937 investment in Alamo by Capital Southwest and its subsidiary was valued at \$45,284,800 (\$16.00 per share), consisting of 2,830,300 restricted shares of common stock, representing a fully-diluted equity interest of 26.2%.

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**The Whitmore Manufacturing Company \$38,000,000**

The Whitmore Manufacturing Company, Rockwall, Texas, manufactures specialty lubricants for heavy equipment used in surface mining, railroads and other industries, and produces water-based coatings for the automotive and primary metals industries. Whitmore's Air Sentry division manufactures fluid contamination control devices. The company's assets also include several commercial real estate interests.

During the year ended March 31, 2008, Whitmore reported net income of \$2,879,000 on net sales of \$23,148,000, compared with net income of \$2,848,000 on net sales of \$20,863,000 in the previous year. The company is owned 80% by Capital Southwest and 20% by Capital Southwest's subsidiary, The RectorSeal Corporation (described on page 6).

At March 31, 2008, the direct investment in 80% of Whitmore by Capital Southwest was valued at \$38,000,000 and had a cost of \$1,600,000.

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**Media Recovery, Inc. \$37,500,000**

Media Recovery, Inc. (MRI) is a holding company of three operating divisions, Media Recovery, ShockWatch and Damage Prevention Company. Its Media Recovery division provides datacenter supplies and services to corporate customers through its direct sales force. Its ShockWatch division manufactures monitoring devices used to detect mishandled shipments and devices for monitoring material handling equipment. Media Recovery's subsidiary, The Damage Prevention Company, Denver, Colorado, manufactures dunnage products used to prevent damage in trucking, rail and export container shipments.

During the year ended September 30, 2007, Media Recovery reported net income of \$4,744,000 on net sales of \$134,180,000, compared with net income of \$5,164,000 on net sales of \$137,040,000 in the previous year.

At March 31, 2008, the \$5,415,000 investment in Media Recovery by Capital Southwest and its subsidiary was valued at \$37,500,000, consisting of 800,000 shares of Series A convertible preferred stock and 4,000,000 shares of common stock, representing a fully-diluted equity interest of 96.9%.

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**Heelys, Inc. \$34,939,913**

Heelys, Inc., Carrollton, Texas, markets and distributes specialty stealth skate footwear, equipment and apparel under the brand name Heelys. The company manufactures its products in China and Korea and distributes them through domestic and international sporting goods chains, department and lifestyle stores and specialty footwear retailers.

During the year ended December 31, 2007, Heelys reported net income of \$22,317,000 (\$0.79 per share) on net sales of \$183,472,000, compared with net income of \$29,174,000 (\$1.16 per share) on net sales of \$188,208,000 in the previous year. The March 31, 2008 closing Nasdaq market price of Heely's common stock was \$4.29 per share.

At March 31, 2008, the \$102,490 investment in Heelys by Capital Southwest's subsidiary was valued at \$34,939,913 (\$3.75 per share), consisting of 9,317,310 restricted shares of common stock, representing a fully-diluted equity interest of 31.8%.

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**Palm Harbor Homes, Inc. \$31,420,484**

Palm Harbor Homes, Dallas, Texas, is an integrated manufacturer and retailer of manufactured and modular housing produced in 12 plants and sold in 29 states by 87 company-owned retail stores and builder locations and approximately 275 independent dealers, builders and developers.

During the year ended March 31, 2008, Palm Harbor reported a net loss of \$124,262,000 (\$5.44 per share) on net sales of \$555,096,000, compared with net loss of \$11,565,000 (\$0.51 per share) on net sales of \$661,247,000 in the previous year. The March 31, 2008 closing Nasdaq market price of Palm Harbor's common stock was \$5.25 per share.

At March 31, 2008, the \$10,931,955 investment in Palm Harbor by Capital Southwest and its subsidiary was valued at \$31,420,484 (\$4.00 per share), consisting of 7,855,121 restricted shares of common stock, representing a fully-diluted equity interest of 30.5%.

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Hologic, Inc. \$17,586,068

Hologic, Inc., Bedford, Massachusetts, is a leading developer, manufacturer and supplier of bone densitometers, mammography and breast biopsy devices, direct-to-digital x-ray systems and other x-ray based imaging systems. These products are generally targeted to address women's healthcare and general radiographic applications.

For the year ended September 29, 2007, Hologic reported net income of \$94,578,000 (\$1.72 per share) on net sales of \$738,368,000, compared with net income of \$27,423,000 (\$0.56 per share) on net sales of \$462,680,000 in the previous year. The March 31, 2008 closing Nasdaq bid price of Hologic's common stock was \$55.58 per share.

At March 31, 2008, Capital Southwest and its subsidiary owned 316,410 unrestricted shares of common stock, having a cost of \$220,000 and a market value of \$17,586,068 (\$55.58 per share).

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All Components, Inc. \$12,600,000

All Components, Inc., Austin, Texas, distributes and produces memory and other electronic components for personal computer manufacturers, retailers, value-added resellers and other corporate customers. Through its Austin-based sales and distribution center and its contract manufacturing plants in Austin, Texas and Boise, Idaho, the company serves over 2,000 customers throughout the United States.

During the year ended August 31, 2007, All Components reported net income of \$134,000 on net sales of \$239,565,000, compared with net income of \$968,000 on net sales of \$275,449,000 in the previous year.

At March 31, 2008, the \$6,150,000 investment in All Components by Capital Southwest and its subsidiary was valued at \$12,600,000 consisting of an 8.25% subordinated note valued at its cost of \$6,000,000 and 150,000 shares of Series A Convertible Preferred Stock valued at \$6,600,000, representing a 79.9% fully-diluted equity interest.

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Texas Capital Bancshares, Inc. \$8,265,393

Texas Capital Bancshares, Inc. of Dallas, Texas, formed in 1998, has total assets of approximately \$4.3 billion. With branch banks in Austin, Dallas, Fort Worth, Houston, Plano and San Antonio, Texas Capital Bancshares conducts its business through its subsidiary, Texas Capital Bank, N.A., which targets middle market commercial and wealthy private client customers in Texas.

For the year ended December 31, 2007, Texas Capital reported net income of \$29,422,000 (\$1.10 per share), compared with net income of \$28,924,000 (\$1.09 per share) in the previous year. The March 30, 2008 closing Nasdaq price of Texas Capital's common stock was \$16.88 per share.

At March 31, 2008, Capital Southwest owned 489,656 unrestricted shares of common stock, having a cost of \$3,550,006 and a market value of \$8,265,393 (\$16.88 per share).

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Extreme International, Inc. \$7,985,000

Extreme International, Inc., Sugar Land, Texas, owns Bill Young Productions, Texas Video and Post, and Extreme Communications, which produce radio and television commercials and corporate communications videos.

During the year ended September 30, 2007, Extreme reported net income of \$1,688,000 on net sales of \$12,470,000, compared with net income of \$1,203,000 on net sales of \$10,342,000 in the previous year.

At March 31, 2008, Capital Southwest and its subsidiary owned 39,359 shares of Series C Convertible Preferred Stock, 3,750 shares of 8% Series A Convertible Preferred Stock and warrants to purchase 13,035 shares of common stock at \$25 per share, having a cost of \$3,000,000 and a market value of \$7,985,000, representing a fully-diluted equity interest of 53.6%.

Portfolio of Investments - March 31, 2008

| Company   | Equity (a) | Investment (b)  | Cost   | Value (c)   |
|---|------------|---|--|---|
| +AT&T, INC.<br>San Antonio, Texas<br>Global leader in local, long distance,<br>Internet and transaction-based voice<br>and data services.   | <1%        | ++20,770 shares common stock<br>(acquired 3-9-99)   | \$ 12  | \$ 795,491  |
| +ALAMO GROUP INC.<br>Seguin, Texas<br>Tractor-mounted mowing and mobile excavation<br>equipment for governmental, industrial and<br>agricultural markets; street-sweeping<br>equipment for municipalities.                  | 26.2%      | 2,830,300 shares common stock<br>(acquired 4-1-73 thru 5-25-07)   | 2,190,937  | 45,284,800  |
| ALL COMPONENTS, INC.<br>Austin, Texas<br>Electronics contract manufacturing; distribution<br>and production of memory and other components for<br>computer manufacturers, retailers and value-added<br>resellers.           | 79.9%      | 8.25% subordinated note due 2012<br>(acquired 6-27-07)<br>150,000 shares Series A Convertible<br>Preferred Stock, convertible into<br>600,000 shares of common stock at<br>\$0.25 per share (acquired 9-16-94)<br>Warrants to purchase 350,000 shares<br>of common stock at \$11.00 per share,<br>expiring 2017 (acquired 6-27-07)  | 6,000,000<br><br>150,000<br><br>--<br><br>-----<br>6,150,000   | 6,000,000<br><br>6,600,000<br><br>--<br><br>-----<br>12,600,000 |
| +ATLANTIC CAPITAL BANCSHARES, INC.<br>Atlanta, Georgia<br>Holding company of Atlantic Capital Bank<br>a full service commercial bank.   | 2.0%       | 300,000 shares common stock<br>(acquired 4-10-07)   | 3,000,000  | 3,000,000   |
| BALCO, INC.<br>Wichita, Kansas<br>Specialty architectural products used<br>in the construction and remodeling of<br>commercial and institutional buildings.   | 88.5%      | 445,000 shares common stock<br>and 60,920 shares Class B<br>non-voting common stock<br>(acquired 10-25-83 and 5-30-02)  | 624,920  | 4,500,000   |
| BOXX TECHNOLOGIES, INC.<br>Austin, Texas<br>Workstations for computer graphics<br>imaging and design.   | 15.2%      | 3,125,354 shares Series B Convertible<br>Preferred Stock, convertible into<br>3,125,354 shares of common stock<br>at \$0.50 per share (acquired 8-20-99<br>thru 8-8-01)   | 1,500,000  | 2   |
| CMI HOLDING COMPANY, INC.<br>Richardson, Texas<br>Owns Chase Medical, which develops and sells<br>devices used in cardiac surgery to relieve<br>congestive heart failure; develops and<br>supports cardiac imaging systems. | 15.3%      | 10% convertible subordinated note,<br>due 2009 (acquired 7-2-07<br>thru 10-9-07)<br>2,327,658 shares Series A Convertible<br>Preferred Stock, convertible into<br>2,327,658 shares of common stock<br>at \$1.72 per share (acquired 8-21-02<br>and 6-4-03)<br>Warrants to purchase 109,012 shares of<br>common stock at \$1.72 per share,<br>expiring 2012 (acquired 4-7-04)<br>Warrant to purchase 431,982 shares of<br>Series A-1 Convertible Preferred<br>Stock at \$1.72 per share expiring 2017<br>(acquired 7-2-07) | 2,363,347<br><br>4,000,000<br><br>--<br><br>-----<br>6,363,347 | 1,000,000<br><br>2<br><br>--<br><br>-----<br>1,000,002          |
| +Publicly-owned company   |            | ++Unrestricted securities as defined in Note (b)  |  |   |

| Company  | Equity (a) | Investment (b)   | Cost                                    | Value (c)                                    |
|--|------------|--|---|--|
| +COMCAST CORPORATION<br>Philadelphia, Pennsylvania<br>Leading provider of cable, entertainment<br>and communications products and services.  | <1%        | ++64,656 shares common stock<br>(acquired 11-18-02)  | \$ 21                                   | \$ 1,248,508                                 |
| DENNIS TOOL COMPANY<br>Houston, Texas<br>Polycrystalline diamond compacts<br>(PDCs) used in oil field drill<br>bits and in mining and industrial<br>applications.  | 67.4%      | 20,725 shares 5% convertible preferred<br>stock, convertible into 20,725 shares<br>of common stock at \$48.25 per share<br>(acquired 8-10-98)<br>140,137 shares common stock<br>(acquired 3-7-94 and 8-10-98)  | 999,981<br>2,329,963<br>3,329,944       | 999,981<br>2,000,000<br>2,999,981            |
| +DISCOVERY HOLDING COMPANY<br>Englewood, Colorado<br>Provider of creative content,<br>media management and network<br>services worldwide.  | <1%        | ++70,501 shares Series A common stock<br>(acquired 7-21-05)  | 20,262                                  | 1,492,506                                    |
| +EMBARQ CORPORATION<br>Overland Park, Kansas<br>Local exchange carrier that provides voice<br>and data services, including high-speed<br>Internet.   | <1%        | ++4,500 shares common stock<br>(acquired 5-17-06)  | 46,532                                  | 180,450                                      |
| +ENCORE WIRE CORPORATION<br>McKinney, Texas<br>Electric wire and cable for<br>residential and commercial use.  | 16.9%      | 4,086,750 shares common stock<br>(acquired 7-16-92 thru 10-7-98)   | 5,800,000                               | 51,084,375                                   |
| EXTREME INTERNATIONAL, INC.<br>Sugar Land, Texas<br>Owns Bill Young Productions, Texas Video<br>and Post, and Extreme Communications,<br>which produce radio and television<br>commercials and corporate<br>communications videos. | 53.6%      | 39,359.18 shares Series C Convertible<br>Preferred Stock, convertible into<br>157,436.72 shares of common stock at<br>\$25.00 per share (acquired 9-30-03)<br>3,750 shares 8% Series A Convertible<br>Preferred Stock, convertible into<br>15,000 shares of common stock at<br>\$25.00 per share (acquired 9-30-03)<br>Warrants to purchase 13,035 shares<br>of common stock at \$25.00 per<br>share, expiring 2008<br>(acquired 8-11-98 thru 9-30-03) | 2,625,000<br>375,000<br>--<br>3,000,000 | 7,026,000<br>669,000<br>290,000<br>7,985,000 |
| +FMC CORPORATION<br>Philadelphia, Pennsylvania<br>Chemicals for agricultural,<br>industrial and consumer markets.  | <1%        | ++12,860 shares common stock<br>(acquired 6-6-86 and 9-13-07)  | 66,726                                  | 713,601                                      |
| +FMC TECHNOLOGIES, INC.<br>Houston, Texas<br>Equipment and systems for the energy,<br>food processing and air transportation<br>industries.  | <1%        | ++22,114 shares common stock<br>(acquired 1-2-02 and 8-31-07)  | 57,051                                  | 1,258,065                                    |
| +Publicly-owned company  |            | ++Unrestricted securities as defined in Note (b)   |   |  |

| Company  | Equity (a) | Investment (b)   | Cost   | Value (c)   |
|--|------------|--|--|---|
| +HEELYS, INC.<br>Carrollton, Texas<br>Heelys stealth skate shoes, equipment<br>and apparel sold through sporting goods<br>chains, department stores and footwear retailers.  | 31.8%      | 9,317,310 shares common stock<br>(acquired 5-26-00)  | \$ 102,490   | \$ 34,939,913   |
| +HOLOGIC, INC.<br>Bedford, Massachusetts<br>Medical instruments including bone<br>densitometers, mammography devices<br>and digital radiography systems.   | <1%        | ++316,410 shares common stock<br>(acquired 8-27-99)  | 220,000  | 17,586,068  |
| +KIMBERLY-CLARK CORPORATION<br>Dallas, Texas<br>Manufacturer of tissue, personal care<br>and health care products.   | <1%        | ++77,180 shares common stock<br>(acquired 12-18-97)  | 2,358,518  | 4,981,969   |
| +LIBERTY GLOBAL, INC.<br>Englewood, Colorado<br>Owns interests in broadband,<br>distribution and content companies.  | <1%        | ++42,463 shares Series A common stock<br>(acquired 6-15-05)<br>++42,463 shares Series C common stock<br>(acquired 9-6-05)  | 106,553<br>100,870<br>-----<br>207,423               | 1,446,714<br>1,377,500<br>-----<br>2,824,214            |
| +LIBERTY MEDIA CORPORATION<br>Englewood, Colorado<br>Holding company owning interests in<br>electronic retailing, media, communi-<br>cations and entertainment businesses.   | <1%        | ++35,250 shares Liberty Capital Series<br>A common stock (acquired 5-9-06)<br>++176,252 shares Liberty Interactive<br>Series A common stock<br>(acquired 5-9-06)<br>++141,000 shares Liberty Entertainment<br>Series A common stock<br>(acquired 3-3-08) | 7,833<br>66,424<br>43,996<br>-----<br>118,253        | 554,130<br>2,842,945<br>3,148,530<br>-----<br>6,545,605 |
| LIFEMARK GROUP<br>Hayward, California<br>Cemeteries, mausoleums and mortuaries<br>located in northern California.  | 100.0%     | 1,449,026 shares common stock<br>(acquired 7-16-69)  | 4,510,400  | 71,000,000  |
| MEDIA RECOVERY, INC.<br>Dallas, Texas<br>Computer datacenter and office automation<br>supplies and accessories; impact, tilt<br>monitoring and temperature sensing devices<br>to detect mishandled shipments; dunnage<br>for protecting shipments. | 96.9%      | 800,000 shares Series A Convertible<br>Preferred Stock, convertible into<br>800,000 shares of common stock at<br>\$1.00 per share (acquired 11-4-97)<br>4,000,000 shares common stock<br>(acquired 11-4-97)  | 800,000<br>4,615,000<br>-----<br>5,415,000           | 6,250,000<br>31,250,000<br>-----<br>37,500,000          |
| PALLETONE, INC.<br>Bartow, Florida<br>Manufacturer of wooden pallets<br>and pressure-treated lumber.   | 8.4%       | 12.3% senior subordinated notes due<br>2012 (acquired 9-25-06)<br>150,000 shares common stock<br>(acquired 10-18-01)<br>Warrant to purchase 15,294 shares of<br>common stock at \$1.00 per share,<br>expiring 2011 (acquired 2-17-06)                    | 1,553,150<br>150,000<br>45,746<br>-----<br>1,748,896 | 2,000,000<br>750,000<br>61,000<br>-----<br>2,811,000    |
| +Publicly-owned company  |            | ++Unrestricted securities as defined in Note (b)   |  |   |

| Company  | Equity (a) | Investment (b)   | Cost                              | Value (c)               |
|--|------------|--|-----------------------------------|-------------------------|
| +PALM HARBOR HOMES, INC.<br>Dallas, Texas<br>Integrated manufacturing, retailing,<br>financing and insuring of manufactured<br>housing and modular homes.  | 30.5%      | 7,855,121 shares common stock<br>(acquired 1-3-85 thru 7-31-95)  | \$ 10,931,955                     | \$ 31,420,484           |
| +PETSMART, INC.<br>Phoenix, Arizona<br>Retail chain of more than 928 stores<br>selling pet foods, supplies and services.   | <1%        | ++300,000 shares common stock<br>(acquired 6-1-95)   | 1,318,771                         | 6,123,000               |
| THE RECTORSEAL CORPORATION<br>Houston, Texas<br>Specialty chemicals for plumbing, HVAC,<br>electrical, construction, industrial,<br>oil field and automotive applications;<br>smoke containment systems for building<br>fires; also owns 20% of The Whitmore<br>Manufacturing Company. | 100.0%     | 27,907 shares common stock<br>(acquired 1-5-73 and 3-31-73)  | 52,600                            | 144,200,000             |
| +SPRINT NEXTEL CORPORATION<br>Reston, Virginia<br>Diversified telecommunications company.  | <1%        | ++90,000 shares common stock<br>(acquired 6-20-84)   | 457,113                           | 602,100                 |
| TCI HOLDINGS, INC.<br>Denver, Colorado<br>Cable television systems<br>and microwave relay systems.   | -          | 21 shares 12% Series C Cumulative<br>Compounding Preferred stock<br>(acquired 1-30-90)   | --                                | 677,250                 |
| +TEXAS CAPITAL BANCSHARES, INC.<br>Dallas, Texas<br>Regional bank holding company with<br>banking operations in six Texas cities.  | 1.6%       | ++489,656 shares common stock<br>(acquired 5-1-00)   | 3,550,006                         | 8,265,393               |
| VIA HOLDINGS, INC.<br>Sparks, Nevada<br>Designer, manufacturer and distributor<br>of high-quality office seating.  | 28.1%      | 9,118 shares Series B Preferred Stock<br>(acquired 9-19-05)<br>1,118 shares Series C Preferred Stock<br>(acquired 11-1-07)   | 4,559,000<br>281,523<br>4,840,523 | 2<br>281,523<br>281,525 |
| WELLOGIX, INC.<br>Houston, Texas<br>Developer and supporter of software<br>used by the oil and gas industry to<br>control drilling and maintenance expenses.   | 19.7%      | 4,726,161 shares Series A-1 Convertible<br>Participating Preferred Stock, con-<br>vertible into 4,726,161 shares of<br>common stock at \$1.0579 per share<br>(acquired 8-19-05 thru 3-15-08) | 5,000,000                         | 2                       |
| THE WHITMORE MANUFACTURING COMPANY<br>Rockwall, Texas<br>Specialized mining, railroad and<br>industrial lubricants; coatings for<br>automobiles and primary metals;<br>fluid contamination control devices.  | 80.0%      | 80 shares common stock<br>(acquired 8-31-79)   | 1,600,000                         | 38,000,000              |
| +WINDSTREAM CORPORATION<br>Little Rock, Arkansas<br>Provider of voice, broadband<br>and entertainment services.  | <1%        | ++9,181 shares common stock<br>(acquired 7-17-06)  | 19,656                            | 109,713                 |
| +Publicly-owned company  |            | ++Unrestricted securities as defined in Note (b)   |                                   |                         |

| Company                 | Equity (a) | Investment (b)  | Cost                   | Value (c)              |
|-------------------------|------------|---|------------------------|------------------------|
| MISCELLANEOUS           | -          | BankCap Partners Fund I, L.P. - 6.0% limited partnership interest (acquired 7-14-06 thru 12-21-07)          | \$ 2,457,140           | \$ 2,457,140           |
|                         | -          | CapitalSouth Partners Fund III, L.P. - 2.8% limited partnership interest (acquired 1-22-08)                 | 701,256                | 701,256                |
|                         | -          | Diamond State Ventures, L.P. - 1.9% limited partnership interest (acquired 10-12-99 thru 8-26-05)           | 111,000                | 111,000                |
|                         | -          | First Capital Group of Texas III, L.P. - 3.3% limited partnership interest (acquired 12-26-00 thru 8-12-05) | 964,604                | 964,604                |
|                         | 100.0%     | Humac Company - 1,041,000 shares common stock (acquired 1-31-75 and 12-31-75)                               | --                     | 181,000                |
|                         | -          | PharmaFab, Inc. - contingent payment agreement (acquired 2-15-07)   | 2                      | 2                      |
|                         | -          | STARTech Seed Fund I - 12.1% limited partnership interest (acquired 4-17-98 thru 1-5-00)                    | 178,066                | 1                      |
|                         | -          | STARTech Seed Fund II - 3.2% limited partnership interest (acquired 4-28-00 thru 2-23-05)                   | 950,000                | 1                      |
|                         | -          | Sterling Group Partners I, L.P. - 1.7% limited partnership interest (acquired 4-20-01 thru 1-24-05)         | 1,064,042              | 1,144,481              |
| TOTAL INVESTMENTS       |            |   | \$ 81,027,466<br>===== | \$547,570,502<br>===== |
| +Publicly-owned company |            | ++Unrestricted securities as defined in Note (b)  |                        |                        |

## Notes to Portfolio of Investments

(a) The percentages in the "Equity" column express the potential equity interests held by Capital Southwest Corporation and Capital Southwest Venture Corporation (together, the "Company") in each issuer. Each percentage represents the amount of the issuer's common stock the Company owns or can acquire as a percentage of the issuer's total outstanding common stock, plus stock reserved for all warrants, convertible securities and employee stock options. The symbol "<1%" indicates that the Company holds a potential equity interest of less than 1%.

(b) Unrestricted securities (indicated by ++) are freely marketable securities having readily available market quotations. All other securities are restricted securities which are subject to one or more restrictions on resale and are not freely marketable. At March 31, 2008, restricted securities represented approximately 90.4% of the value of the consolidated investment portfolio.

(c) Under the valuation policy of the Company, unrestricted securities are valued at the closing sale price for NYSE listed securities and at the lower of the closing bid price or the last sale price for Nasdaq securities on the valuation date. Restricted securities, including securities of publicly-owned companies which are subject to restrictions on resale, are valued at fair value as determined by the Board of Directors. Fair value is considered to be the amount which the Company may reasonably expect to receive for portfolio securities if such securities were sold on the valuation date. Valuations as of any particular date, however, are not necessarily indicative of amounts which may ultimately be realized as a result of future sales or other dispositions of securities.

Among the factors considered by the Board of Directors in determining the fair value of restricted securities are the logic and methodology of SFAS 157, the financial condition and operating results of the issuer, the long-term potential of the business of the issuer, the market for and recent sales prices of the issuer's securities, the values of similar securities issued by companies in similar businesses, the proportion of the issuer's securities owned by the Company, the nature and duration of resale restrictions and the nature of any rights enabling the Company to require the issuer to register restricted securities under applicable securities laws. In determining the fair value of restricted securities, the Board of Directors considers the inherent value of such securities without regard to the restrictive feature and adjusts for any diminution in value resulting from restrictions on resale. The values of the Company's top four wholly or majority owned assets determined by our Board of Directors, were reviewed by a nationally-recognized valuation firm as of March 31, 2008.

(d) Agreements between certain issuers and the Company provide that the issuers will bear substantially all costs in connection with the disposition of common stock, including those costs involved in registration under the Securities Act of 1933 but excluding underwriting discounts and commissions. These agreements cover common stock owned at March 31, 2008 and common stock which may be acquired thereafter through the exercise of warrants and conversion of debentures and preferred stock. They apply to restricted securities of all issuers in the investment portfolio of the Company except securities of the following issuers, which are not obligated to bear registration costs: Humac Company, Lifemark Group and The Whitmore Manufacturing Company.

(e) The descriptions of the companies and ownership percentages shown in the portfolio of investments were obtained from published reports and other sources believed to be reliable, are supplemental and are not covered by the report of our independent registered public accounting firm. Acquisition dates indicated are the dates specific securities were acquired, which may differ from the original investment dates. Certain securities were received in exchange for or upon conversion or exercise of other securities previously acquired.

## Portfolio Changes During the Year

### New Investments and Additions to Previous Investments

|  | Amount       |
|--|--------------|
|  | -----        |
| Alamo Group Inc.....                     | \$ 125,890   |
| All Components, Inc.....                 | 3,000,000    |
| Atlantic Capital Bancshares, Inc.....    | 3,000,000    |
| BankCap Partners Fund I, L.P.....        | 1,861,521    |
| CapitalSouth Partners Fund III, L.P..... | 701,255      |
| CMI Holding Company, Inc.....            | 1,763,347    |
| VIA Holdings, Inc.....                   | 281,523      |
|  | -----        |
|  | \$10,733,536 |
|  | =====        |

### Dispositions

|                                     | Cost        | Amount<br>Received |
|-------------------------------------|-------------|--------------------|
|                                     | -----       | -----              |
| Alltel Corporation .....            | \$ 88,699   | \$ 634,920         |
| Diamond State Ventures, L.P.....    | 35,000      | 35,000             |
| Exopack, Inc.....                   | -           | 245,950            |
| Hic-Star Corporation.....           | 1,070,168   | 1                  |
| Sterling Group Partners I, L.P..... | -           | 518,020            |
|                                     | -----       | -----              |
|                                     | \$1,193,867 | \$1,433,891        |
|                                     | =====       | =====              |
| Repayments Received.....            |             | \$154,500          |
|                                     |             | =====              |

Capital Southwest Corporation and Subsidiaries Consolidated Statements of Financial Condition

| Assets                              | March 31      |               |
|-------------------------------------|---------------|---------------|
|                                     | 2008          | 2007          |
| Investments at market or fair value |               |               |
| Companies more than 25% owned       |               |               |
| (Cost: 2008 - \$28,758,246,         |               |               |
| 2007 - \$28,632,356).....           | \$410,026,178 | \$526,993,983 |
| Companies 5% to 25% owned           |               |               |
| (Cost: 2008 - \$20,412,243,         |               |               |
| 2007 - \$18,798,896).....           | 54,895,381    | 76,398,002    |
| Companies less than 5% owned        |               |               |
| (Cost: 2008 - \$31,856,977,         |               |               |
| 2007 - \$24,211,045).....           | 82,648,943    | 77,763,048    |
|                                     | -----         | -----         |
| Total investments                   |               |               |
| (Cost: 2008 - \$81,027,466,         |               |               |
| 2007 - \$71,642,297).....           | 547,570,502   | 681,155,033   |
| Cash and cash equivalents.....      | 31,327,758    | 38,844,203    |
| Receivables.....                    | 156,322       | 337,892       |
| Other assets.....                   | 7,630,486     | 9,170,185     |
|                                     | -----         | -----         |
| Totals.....                         | \$586,685,068 | \$729,507,313 |

| Liabilities and Shareholders' Equity     | March 31     |              |
|--|--------------|--------------|
|  | 2008         | 2007         |
| Other liabilities.....                   | \$ 1,187,796 | \$ 1,457,847 |
| Deferred income taxes.....               | 1,797,058    | 2,317,777    |
|  | -----        | -----        |
| Total liabilities .....                  | 2,984,854    | 3,775,624    |
|  | -----        | -----        |
| Shareholders' equity                     |              |              |
| Common stock, \$1 par value: authorized, |              |              |
| 5,000,000 shares; issued, 4,326,516      |              |              |
| shares at March 31, 2008 and 4,323,416   |              |              |
| shares at March 31, 2007.....            | 4,326,516    | 4,323,416    |
| Additional capital.....                  | 115,687,153  | 116,373,960  |
| Undistributed net investment income..... | 7,036,929    | 5,655,020    |
| Undistributed net realized loss on       |              |              |
| investments.....                         | (2,860,118)  | (3,100,142)  |
| Unrealized appreciation of investments.. | 466,543,036  | 609,512,737  |
| Treasury stock - at cost                 |              |              |
| (437,365 shares).....                    | (7,033,302)  | (7,033,302)  |
|  | -----        | -----        |

Net assets at market or fair value, equivalent to \$150.09 per share at March 31, 2008 on the 3,889,151 shares outstanding and \$186.75 per share at March 31, 2007 on the

|                                   |               |               |
|-----------------------------------|---------------|---------------|
| 3,886,051 shares outstanding..... | 583,700,214   | 725,731,689   |
|                                   | -----         | -----         |
| Totals.....                       | \$586,685,068 | \$729,507,313 |
|                                   | =====         | =====         |

The accompanying Notes are an integral part of these Consolidated Financial Statements

Capital Southwest Corporation and Subsidiaries  
Consolidated Statements of Operations

|  | Years Ended March 31 |                |                |
|--|----------------------|----------------|----------------|
|  | 2008                 | 2007           | 2006           |
| Investment income:   |                      |                |                |
| Interest .....   | \$ 2,255,550         | \$ 2,308,660   | \$ 505,536     |
| Dividends .....  | 3,656,833            | 3,954,875      | 3,485,430      |
| Management and directors' fees .....                                 | 882,300              | 708,900        | 848,070        |
|  | 6,794,683            | 6,972,435      | 4,839,036      |
| Operating expenses:  |                      |                |                |
| Salaries .....   | 1,619,008            | 1,356,062      | 1,211,584      |
| Net pension benefit .....  | (327,345)            | (144,945)      | (116,747)      |
| Other operating expenses .....                                       | 1,676,660            | 1,014,255      | 859,702        |
|  | 2,968,323            | 2,225,372      | 1,954,539      |
| Income before interest expense and income taxes .....                | 3,826,360            | 4,747,063      | 2,884,497      |
| Interest expense .....   | --                   | 460,399        | 436,021        |
| Income before income taxes .....                                     | 3,826,360            | 4,286,664      | 2,448,476      |
| Income tax expense .....   | 111,160              | 53,324         | 59,220         |
| Net investment income .....  | \$ 3,715,200         | \$ 4,233,340   | \$ 2,389,256   |
| Proceeds from disposition of investments .....                       | \$ 1,433,891         | \$ 42,919,988  | \$ 30,802,552  |
| Cost of investments sold .....                                       | 1,193,867            | 16,872,993     | 10,523,986     |
| Realized gain on investments before income taxes .....               | 240,024              | 26,046,995     | 20,278,566     |
| Income tax expense .....   | --                   | 11,080,699     | 4,827,663      |
| Net realized gain on investments .....                               | 240,024              | 14,966,296     | 15,450,903     |
| Net increase (decrease) in unrealized appreciation of investments .. | (142,969,698)        | 147,681,609    | 124,355,303    |
| Net realized and unrealized gain (loss) on investments .....         | \$(142,729,674)      | \$ 162,647,905 | \$ 139,806,206 |
| Increase (decrease) in net assets from operations .....              | \$(139,014,474)      | \$ 166,881,245 | \$ 142,195,462 |

The accompanying Notes are an integral part of these  
Consolidated Financial Statements

Capital Southwest Corporation and Subsidiaries  
Consolidated Statements of Changes in Net Assets

|   | Years Ended March 31 |                |                |
|---|----------------------|----------------|----------------|
|   | 2008                 | 2007           | 2006           |
| Operations:   |                      |                |                |
| Net investment income .....   | \$ 3,715,200         | \$ 4,233,340   | \$ 2,389,256   |
| Net realized gain on investments .....                                  | 240,024              | 14,966,296     | 15,450,903     |
| Net increase (decrease) in unrealized appreciation of investments ..... | (142,969,698)        | 147,681,609    | 124,355,303    |
| Increase (decrease) in net assets from operations .....                 | (139,014,474)        | 166,881,245    | 142,195,462    |
| Distributions from:   |                      |                |                |
| Undistributed net investment income .....                               | (2,333,291)          | (2,323,150)    | (2,314,231)    |
| Net realized gains deemed distributed to shareholders .....             | --                   | (11,417,283)   | (13,573,139)   |
| Capital share transactions:   |                      |                |                |
| Allocated increase in share value for deemed distribution .....         | --                   | 11,417,283     | 13,573,139     |
| Exercise of employee stock options .....                                | 231,390              | 1,794,850      | 208,000        |
| Adjustment to initially apply FASB No. 158, net of tax .....            | --                   | 1,173,751      | --             |
| Change in pension plan funded status .....                              | (1,178,764)          | --             | --             |
| Stock option expense .....  | 263,664              | 169,003        | --             |
| Increase (decrease) in net assets .....                                 | (142,031,475)        | 167,695,699    | 140,089,231    |
| Net assets, beginning of year .....                                     | 725,731,689          | 558,035,990    | 417,946,759    |
| Net assets, end of year .....   | \$ 583,700,214       | \$ 725,731,689 | \$ 558,035,990 |

The accompanying Notes are an integral part of these  
Consolidated Financial Statements

Capital Southwest Corporation and Subsidiaries  
Consolidated Statements of Cash Flows

|   | Years Ended March 31 |                |                |
|---|----------------------|----------------|----------------|
|   | 2008                 | 2007           | 2006           |
| Cash flows from operating activities  |                      |                |                |
| Increase (decrease) in net assets from operations   | \$(139,014,474)      | \$ 166,881,245 | \$ 142,195,462 |
| Adjustments to reconcile increase in net assets from operations to net cash provided by (used in) operating activities: |                      |                |                |
| Proceeds from disposition of investments  | 1,433,891            | 42,919,988     | 30,802,552     |
| Purchases of securities   | (10,733,536)         | (803,269)      | (15,054,741)   |
| Maturities of securities  | 154,500              | 884,935        | 480,197        |
| Depreciation and amortization   | 32,756               | 16,808         | 16,136         |
| Net pension benefit   | (327,345)            | (144,945)      | (116,747)      |
| Realized gain on investments before income taxes  | (240,024)            | (14,966,296)   | (15,450,905)   |
| Net (increase) decrease in unrealized appreciation of investments   | 142,969,698          | (147,681,609)  | (124,355,303)  |
| Stock option expense  | 263,664              | 169,003        | --             |
| (Increase) decrease in receivables  | 181,570              | (202,005)      | 514            |
| Increase in other assets  | (80,195)             | (39,982)       | (3,226)        |
| Increase (decrease) in other liabilities  | (33,281)             | 8,934          | (67,245)       |
| Decrease in accrued pension liability   | (135,768)            | (144,171)      | (154,673)      |
| Increase in deferred income taxes   | 114,000              | 50,700         | 40,800         |
| Net cash provided by (used in) operating activities   | (5,414,544)          | 46,949,336     | 18,332,821     |
| Cash flows from financing activities  |                      |                |                |
| Decrease in note payable to bank  | --                   | (8,000,000)    | --             |
| Decrease in note payable to portfolio company   | --                   | --             | (5,000,000)    |
| Distributions from undistributed net investment income  | (2,333,291)          | (2,323,150)    | (2,314,231)    |
| Proceeds from exercise of employee stock options  | 231,390              | 1,794,850      | 208,000        |
| Payment of federal income tax for deemed capital gains distribution   | --                   | (11,080,699)   | (4,827,659)    |
| Net cash used in financing activities   | (2,101,901)          | (19,608,999)   | (11,933,890)   |
| Net increase (decrease) in cash and cash equivalents  | (7,516,445)          | 27,340,337     | 6,398,931      |
| Cash and cash equivalents at beginning of year  | 38,844,203           | 11,503,866     | 5,104,935      |
| Cash and cash equivalents at end of year  | \$ 31,327,758        | \$ 38,844,203  | \$ 11,503,866  |
| Supplemental disclosure of cash flow information:   |                      |                |                |
| Cash paid during the year for:  |                      |                |                |
| Interest  | \$ --                | \$ 460,399     | \$ 436,920     |
| Income taxes  | \$ --                | \$ 20,000      | \$ 18,420      |

The accompanying Notes are an integral part of these Consolidated Financial Statements

## Notes to Consolidated Financial Statements

### 1. Summary of Significant Accounting Policies

Capital Southwest Corporation ("CSC") is a business development company subject to regulation under the Investment Company Act of 1940. Capital Southwest Venture Corporation ("CSVC"), a wholly-owned subsidiary of CSC, is a Federal licensee under the Small Business Investment Act of 1958. Capital Southwest Management Corporation ("CSMC"), a wholly-owned subsidiary of CSC, is the management company for CSC and CSVC. The following is a summary of significant accounting policies followed in the preparation of the consolidated financial statements of CSC, CSVC and CSMC (together, the "Company"):

**Principles of Consolidation.** The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for investment companies. Under rules and regulations applicable to investment companies, we are precluded from consolidating any entity other than another investment company. An exception to this general principle occurs if the investment company has an investment in an operating company that provides services to the investment company. Our consolidated financial statements include our management company, CSMC.

**Cash and Cash Equivalents.** All temporary cash investments having a maturity of three months or less when purchased are considered to be cash equivalents.

**Investments.** Investments are stated at market or fair value determined by the Board of Directors as described in the Notes to Portfolio of Investments and Note 2 below. The average cost method is used in determining cost of investments sold. Investments are recorded on a trade date basis. Dividends are recognized on the ex-dividend date and interest income is accrued daily.

**Segment Information.** The Company operates and manages its business in a singular segment. As an investment company, the Company invests in portfolio companies in various industries and geographic areas as presented in the portfolio of investments.

**Use of Estimates.** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**Federal Income Taxes.** CSC and CSVC intend to comply with the requirements of the Internal Revenue Code necessary to qualify as regulated investment companies (RICs). By meeting these requirements, they will not be subject to corporate federal income taxes on ordinary income distributed to shareholders. The Company's policy is to retain and pay the 35% corporate tax on realized long-term capital gains. For investment companies that qualify as RICs under the IRC, federal income taxes payable on security gains that the company elects to retain are accrued only on the last day of the tax year, December 31. Therefore, CSC and CSVC made no provision for federal income taxes on such gains and net investment income in their financial statements.

CSMC, a wholly owned subsidiary of CSC, is not a RIC and is required to pay taxes at the current corporate rate.

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48 ("FIN 48"), which clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a

tax return. The Company adopted FIN 48 on April 1, 2007, which had no effect on the Company's financial statements.

**Deferred Taxes.** The Company sponsors a qualified defined benefit pension plan which covers its employees and employees of certain of its wholly-owned portfolio companies. Deferred taxes related to the qualified defined benefit pension plan are recorded as incurred.

**Stock-Based Compensation.** In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R), which revised SFAS 123. SFAS 123R also supersedes APB 25 and amends SFAS No. 95, Statement of Cash Flows. SFAS 123R eliminates the alternative to account for employee stock options under APB 25 and requires that the fair value of all share-based payments to employees, including the fair value of grants of employee stock options, be recognized in the income statement, generally over the vesting period.

In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 107, which provides additional implementation guidance for SFAS 123R. Among other things, SAB 107 provides guidance on share-based payment valuations, income statement classification and presentation, capitalization of costs and related income tax accounting.

Effective April 1, 2006, the Company adopted SFAS 123R using the modified prospective transition method. The Company recognizes compensation cost over the straight-line method for all share-based payments granted on or after that date and for all awards granted to employees prior to April 1, 2006 that remain unvested on that date. The fair value of stock options are determined on the date of grant using the Black-Scholes pricing model and are expensed over the vesting period of the related stock options. Accordingly, for the years ended March 31, 2008 and March 31, 2007, the Company recognized compensation expense of \$263,664 and \$169,003, respectively.

As of March 31, 2008, the total remaining unrecognized compensation cost related to non-vested stock options was \$1,795,834 which will be amortized over the weighted-average service period of approximately 5.90 years.

### **Defined Pension Benefits and Other Postretirement Plans**

Effective March 31, 2007, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements Nos. 87, 88, 106 and 132R (SFAS 158). SFAS 158 is required to be adopted on a prospective basis and prior year financial statements and related disclosures are not permitted to be restated. SFAS 158 requires an employer that sponsors one or more postretirement defined benefit plan(s) to:

- o Recognize the funded status of postretirement defined benefit plans - measured as the difference between the fair value of plan assets and the benefit obligations - in its balance sheet.
- o Recognize changes in the funded status of postretirement defined benefit plans in shareholder's equity in the year in which the changes occur.
- o Measure postretirement defined benefit plan assets and obligations as of the date of the employer's fiscal year-end. The Company presently uses March 31 as the measurement date for all of its postretirement defined benefit plans.

### **Recent Accounting Pronouncements**

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements, ("SFAS 157"). Effective April 1, 2008, the Company adopted SFAS 157. In February 2008, the FASB issued Staff Position No. 157-2, Effective Date of FASB Statement No. 157 ("FSP 157-2"), which delayed the effective date of SFAS 157 for certain nonfinancial assets and liabilities, including fair value

measurements under SFAS 141 and SFAS 142 of goodwill and other intangible assets, to fiscal years beginning after November 15, 2008. Therefore, the Company has adopted the provisions of SFAS 157 with respect to its financial assets and liabilities only. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. Fair value is defined under SFAS 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on the following three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets or liabilities; Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. The Company is currently evaluating this statement and does not anticipate that the adoption of SFAS 157 will have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The Company is currently evaluating this statement and has made elections. However, our investments are carried at fair value, the Company does not anticipate that this Statement would have a significant impact on the consolidated financial statements.

## 2. Valuation of Investments

The consolidated financial statements as of March 31, 2008 and 2007 include restricted securities valued at \$494,843,820 (90.4% of the value of the consolidated investment portfolio) and \$619,207,702 (90.9% of the value of the consolidated investment portfolio), respectively, whose values have been determined by the Board of Directors in the absence of readily ascertainable market values. Because of the inherent uncertainty of valuation, these values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material. Unrestricted securities are valued at the closing sale price for NYSE listed securities and at the lower of the closing bid price or the last sale price for Nasdaq securities on the valuation date.

## 3. Income Taxes

For the tax years ended December 31, 2007 and 2006, CSC and CSVC qualified to be taxed as RICs under applicable provisions of the Internal Revenue Code. As RICs, CSC and CSVC must distribute at least 90% of their taxable net investment income (investment company taxable income) and may either distribute or retain their taxable net realized gain on investments (capital gains). To the extent that we retain capital gains and declare a deemed dividend to shareholders, at the corporate rate, on the distribution, and the shareholders would receive a tax credit equal to their proportionate share of the tax paid.

We intend to meet the applicable qualifications to be taxed as a RIC in future years; management feels it is probable that we will maintain our RIC status for a period longer than one year; however, either company's ability to meet certain portfolio diversification requirements of RICs in future years may not be controllable by such company.

As permitted by the Internal Revenue Code, a RIC can designate dividends paid in the subsequent tax year as dividends of the current year ordinary taxable income and long-term capital gains if those dividends are both declared by the extended due date of the RIC's federal income tax return and paid to shareholders by the last day of the subsequent tax year. For the tax years ended December 31, 2007 and 2006 we declared and paid dividends in the amounts of \$2,333,291 and \$2,323,150, respectively.

Additionally, we are also subject to a nondeductible federal excise tax of 4% if we do not distribute at least 98% of our investment company ordinary taxable income during our tax year. For the tax years ended December 31, 2007 and 2006, we distributed 100% of our investment company ordinary taxable income. As a result, we have made no provision for income taxes on ordinary taxable income for the tax years ended December 31, 2007 and 2006.

For the tax year ended December 31, 2007, we have an estimated net long-term capital loss of \$961,655 for tax purposes and \$860,118 for book purposes, which will be carried forward and offset by future net long-term capital gains. For the tax year ended December 31, 2006, we had net long-term capital gains of \$31,659,140 for tax purposes and \$31,932,775 for book purposes, which we elected to retain and treat as a deemed distribution to our shareholders. In order to make the election to retain capital gains, we incurred and paid a federal tax on behalf of our shareholders of \$11,080,699 for the tax year ended December 31, 2006.

CSMC, a wholly owned subsidiary of CSC, is not a RIC and is required to pay taxes at the current corporate rate. The Company sponsors a qualified defined benefit pension plan which covers its employees and employees of certain of our wholly owned portfolio companies. Deferred taxes related to the qualified defined pension plan are recorded as incurred.

#### 4. Undistributed Net Realized Gains (Losses) on Investments

Distributions made by RICs often differ from aggregate GAAP-basis undistributed net investment income and accumulated net realized gains (total GAAP-basis net realized gains). The principal cause is that required minimum fund distributions are based on income and gain amounts determined in accordance with federal income tax regulations, rather than GAAP. The differences created can be temporary, meaning that they will reverse in the future, or they can be permanent. In subsequent periods, when all or a portion of a temporary difference becomes a permanent difference, the amount of the permanent difference will be reclassified to "additional capital."

For income tax purposes, the \$11,417,283 and \$13,573,139 are treated as deemed distributions to our shareholders for the tax years ended December 31, 2006 and 2005. We reclassified the deemed distribution, net of tax, from our undistributed net realized earnings capital in excess of par value. For the tax year ended December 31, 2004, to the extent we had capital gains, they were fully offset by either capital losses or capital loss carry forwards.

As of March 31, 2008 and 2007, our undistributed net realized gains (losses) on investments determined in accordance with GAAP as reflected on our consolidated statement of financial condition were comprised of the following:

| As of March 31,<br>-----                                    | 2008<br>----- | 2007<br>----- |
|---|---------------|---------------|
| Undistributed net realized gains<br>(losses) on investments | (\$2,860,118) | (\$3,100,142) |

#### 5. Employee Stock Option Plan

On July 19, 1999, shareholders approved the 1999 Stock Option

Plan ("Plan"), which provided for the granting of stock options to employees and officers of the Company and authorized the issuance of common stock upon exercise of such options for up to 140,000 shares. All options are granted at or above market price, generally expire 10 years from the date of grant and are generally exercisable on or after the first anniversary of the date of grant in 5 to 10 annual installments.

At March 31, 2008, there were 37,500 shares available for grant under the Plan. The per share weighted-average fair value of the stock options granted on May 15, 2006 was \$31.276 per option using the Black-Scholes pricing model with the following assumptions: expected dividend yield of 0.64%, risk-free interest rate of 5.08%, expected volatility of 21.1%, and expected life of 7 years. The per share weighted-average fair value of the stock options granted on July 17, 2006 was \$33.045 per option using the Black-Scholes pricing model with the following assumptions: expected dividend yield of 0.61%, risk-free interest rate of 5.04%, expected volatility of 21.2%, and expected life of 7 years. The per share weighted-average fair value of the stock options granted on July 16, 2007 was \$41.78 per option using the Black-Scholes pricing model with the following assumptions: expected dividend yield of 0.39%, risk-free interest rate of 4.95%, expected volatility of 19.9%, and expected life of 5 years.

The following summarizes activity in the stock option plans for the years ended March 31, 2008, 2007 and 2006:

|                           | Number<br>of shares | Weighted Average<br>Exercise Price |
|---------------------------|---------------------|------------------------------------|
|                           | -----               | -----                              |
| Balance at March 31, 2006 | 45,300              | \$ 68.411                          |
| Granted                   | 57,500              | 94.136                             |
| Exercised                 | (25,800)            | 69.568                             |
| Canceled                  | (24,500)            | 89.482                             |
|                           | -----               | -----                              |
| Balance at March 31, 2007 | 52,500              | 86.184                             |
| Granted                   | 25,000              | 152.980                            |
| Exercised                 | (3,100)             | 74.642                             |
| Canceled                  | (4,000)             | 93.490                             |
|                           | -----               | -----                              |
| Balance at March 31, 2008 | 70,400              | \$109.998                          |
|                           | =====               | =====                              |

|                | Weighted Average<br>Remaining Contractual Term | Aggregate Intrinsic<br>Value |
|----------------|--|------------------------------|
|                | -----  | -----                        |
| March 31, 2008 |  |                              |
| Outstanding    | 5.9 years                                      | \$2,184,883                  |
| Exercisable    | 5.5 years                                      | \$ 241,320                   |

At March 31, 2008, the range of exercise prices and weighted-average remaining contractual life of outstanding options was \$65.00 to \$152.98 and 5.91 years, respectively. The total intrinsic value of options exercised during the years ended March 31, 2008, 2007 and 2006 were \$75,129, \$571,565 and \$66,147, respectively. The exercise prices ranged from \$65.00 to \$93.49 per share for the year ended March 31, 2008 and \$65.00 to \$77.00 per share for the each of the years ended March 31, 2007 and 2006. New shares were issued for the \$231,390, \$1,794,850 and \$208,000 cash received from option exercises for the years ended March 31, 2008, 2007 and 2006, respectively.

At March 31, 2008, 2007 and 2006, the number of options exercisable was 9,930, 8,515 and 29,500, respectively and the weighted-average exercise price of those options was \$79.01, \$78.51 and \$69.01, respectively.

## 6. Employee Stock Ownership Plan

The Company and one of its wholly-owned portfolio companies sponsor a qualified employee stock ownership plan ("ESOP") in which certain employees participate. Contributions to the plan, which are invested in Company stock, are made at the discretion of the Board of Directors. A participant's interest in contributions to the ESOP fully vests after five years of active service.

Effective April 1, 2007, the vesting period for the ESOP is three years. During the 3 years ended March 31, 2008, the Company made contributions to the ESOP, which were charged against net investment income, of \$94,210 in 2008, \$84,488 in 2007 and \$99,167 in 2006.

## 7. Retirement Plans

The Company sponsors a qualified defined benefit pension plan which covers its employees and employees of certain of its wholly-owned portfolio companies. The following information about the plan represents amounts and information related to the Company's participation in the plan and is presented as though the Company sponsored a single-employer plan. Benefits are based on years of service and an average of the highest five consecutive years of compensation during the last 10 years of employment. The funding policy of the plan is to contribute annual amounts that are currently deductible for tax reporting purposes. No contribution was made to the plan during the three years ended March 31, 2008.

The following tables set forth the qualified plan's benefit obligations and fair value of plan assets at March 31, 2008, 2007 and 2006:

|   | Years Ended March 31 |              |              |
|---|----------------------|--------------|--------------|
|   | 2008                 | 2007         | 2006         |
| Change in benefit obligation                        |                      |              |              |
| Benefit obligation at beginning of year.....        | \$3,965,100          | \$4,004,017  | \$3,833,411  |
| Service cost.....                                   | 67,514               | 103,342      | 95,590       |
| Interest cost.....                                  | 222,895              | 230,711      | 223,374      |
| Actuarial loss.....                                 | (160,840)            | 68,854       | 228,122      |
| Benefits paid.....                                  | (395,384)            | (386,982)    | (376,480)    |
| Plan change.....                                    | --                   | (54,842)     | --           |
| Benefit obligation at end of year ....              | \$3,699,285          | \$3,965,100  | \$4,004,017  |
| Change in plan assets                               |                      |              |              |
| Fair value of plan assets at beginning of year..... | \$12,973,292         | \$11,640,693 | \$9,326,254  |
| Actual return on plan assets.....                   | (1,457,571)          | 1,719,581    | 2,690,919    |
| Benefits paid.....                                  | (395,384)            | (386,982)    | (376,480)    |
| Fair value of plan assets at end of year.....       | \$11,120,337         | \$12,973,292 | \$11,640,693 |

The following table sets forth the qualified plan's funded status and amounts recognized in the Company's consolidated statements of financial condition:

|  | March 31      |               |
|--|---------------|---------------|
|  | 2008          | 2007          |
| Actuarial present value of benefit obligations:  |               |               |
| Accumulated benefit obligation.....  | \$(3,387,397) | \$(3,435,396) |
| Projected benefit obligation for service rendered to date.....   | \$(3,699,285) | \$(3,965,100) |
| Plan assets at fair value*.....  | 11,120,337    | 12,973,292    |
| Funded status.....   | 7,421,052     | 9,008,192     |
| Unrecognized net (gain) loss from past experience different from that assumed and effects of changes in assumptions..... | 209,044       | (1,761,054)   |
| Unrecognized prior service costs.....  | 129,179       | 132,904       |
| Additional asset, FAS 158.....   | (338,223)     | 1,628,150     |
| Prepaid pension cost included in other assets ...  | \$7,421,052   | \$9,008,192   |

\*Primarily equities and bonds including approximately 25,000 shares of common stock of the Company.

Components of net pension benefit related to the qualified plan include the following:

|  | Years Ended March 31 |           |          |
|--|----------------------|-----------|----------|
|  | 2008                 | 2007      | 2006     |
| Service cost - benefits earned during the year ..... | \$67,514             | \$103,342 | \$95,590 |
| Interest cost on projected benefit                   |                      |           |          |

|   |              |              |              |
|---|--------------|--------------|--------------|
| obligation .....                        | 222,895      | 230,711      | 223,374      |
| Expected return on assets .....         | (673,366)    | (580,104)    | (551,026)    |
| Net amortization .....                  | 3,725        | 27,487       | 38,897       |
|   | -----        | -----        | -----        |
| Net pension benefit from qualified plan | \$ (379,232) | \$ (218,564) | \$ (193,165) |
|   | =====        | =====        | =====        |

The Company also sponsors an unfunded Retirement Restoration Plan, which is a nonqualified plan that provides for the payment, upon retirement, of the difference between the maximum annual payment permissible under the qualified retirement plan pursuant to Federal limitations and the amount which would otherwise have been payable under the qualified plan.

The following table sets forth the Retirement Restoration Plan's benefit obligations at March 31, 2008, 2007 and 2006:

|  | Years Ended March 31 |             |             |
|--|----------------------|-------------|-------------|
|  | 2008                 | 2007        | 2006        |
| Change in benefit obligation                 |                      |             |             |
| Benefit obligation at beginning of year..... | \$1,178,891          | \$1,280,542 | \$1,302,368 |
| Service cost.....                            | 10,483               | 20,245      | 19,094      |
| Interest cost.....                           | 57,588               | 68,937      | 72,886      |
| Actuarial (gain) loss.....                   | (169,072)            | (36,529)    | 40,867      |
| Benefits paid.....                           | (135,768)            | (144,170)   | (154,673)   |
| Plan change.....                             | --                   | (10,134)    | --          |
| Benefit obligation at end of year ...        | \$ 942,122           | \$1,178,891 | \$1,280,542 |

The following table sets forth the status of the Retirement Restoration Plan and the amounts recognized in the consolidated statements of financial condition:

|  | March 31    |               |
|--|-------------|---------------|
|  | 2008        | 2007          |
| Projected benefit obligation .....   | \$(942,122) | \$(1,178,891) |
| Unrecognized net loss from past experience different from that assumed and effects of changes in assumptions ..... | (112,552)   | 56,523        |
| Unrecognized prior service costs .....   | (217,958)   | (234,144)     |
| Additional asset, FAS 158 .....  | 330,510     | 177,621       |
| Accrued pension cost included in other liabilities ..  | \$(942,122) | \$(1,178,891) |

The Retirement Restoration Plan expenses recognized during the years ended March 31, 2008, 2007 and 2006 of \$51,885, \$73,619 and \$76,417, respectively, are offset against the net pension benefit from the qualified plan.

The following assumptions were used in estimating the actuarial present value of the projected benefit obligations:

|                                     | Years Ended March 31 |      |       |
|-------------------------------------|----------------------|------|-------|
|                                     | 2008                 | 2007 | 2006  |
| Discount rate.....                  | 6.25%                | 6.0% | 5.75% |
| Rate of compensation increases..... | 5.0%                 | 5.0% | 5.0%  |

The following assumptions were used in estimating the net periodic (income)/expense:

|                                     | Years Ended March 31 |       |       |
|-------------------------------------|----------------------|-------|-------|
|                                     | 2008                 | 2007  | 2006  |
| Discount rate.....                  | 6.0%                 | 5.75% | 5.75% |
| Expected return on plan assets..... | 6.5%                 | 6.0%  | 6.0%  |
| Rate of compensation increases..... | 5.0%                 | 5.0%  | 5.0%  |

The expected rate of return on assets assumption was determined based on the anticipated performance of the various asset classes in the plan's portfolio and the allocation of assets to each class. The anticipated asset class return is developed using historical and predicted asset return performance, considering the investments underlying each asset class and expected investment performance based on forecasts of inflation, interest rates and market indices for fixed income and equity securities.

The Company's pension plan asset allocations are as follows:

Percentage of plan assets  
at March 31

| Asset Category         | 2008   | 2007   |
|------------------------|--------|--------|
| Equity securities..... | 75.0%  | 79.1%  |
| Debt securities.....   | 13.8%  | 11.4%  |
| Cash .....             | 11.2%  | 9.5%   |
|                        | 100.0% | 100.0% |

The Company's pension plan is administered by a board-appointed committee of that has fiduciary responsibility for the plan's management. The trustee of the

plan is JPMorgan Asset Management. Currently, approximately 18% of the assets are selected and managed by the trustee and the remainder of the assets are managed by the committee, invested mostly in equity securities, including the Company's stock.

Following are the expected benefit payments for the next five years and in the aggregate for the years 2014-2018:

| (In Thousands) | Years Ended March 31 |       |       |       |       | 2014-   |
|----------------|----------------------|-------|-------|-------|-------|---------|
|                | 2009                 | 2010  | 2011  | 2012  | 2013  | 2018    |
|                | \$362                | \$339 | \$316 | \$301 | \$277 | \$1,143 |

Incremental effect of applying FASB Statement No. 158 on individual line items in the Statement of Financial Condition:

|  | March 31, 2007                         |             | After application<br>of Statement 158 |
|--|--|-------------|---------------------------------------|
|  | Before Application<br>Of Statement 158 | Adjustments |                                       |
| Other assets.....                          | \$ 7,542,035                           | \$1,628,150 | \$ 9,170,185                          |
| Other liabilities.....                     | 1,635,468                              | (177,621)   | 1,457,847                             |
| Deferred income taxes....                  | 1,144,026                              | 1,173,751   | 2,317,777                             |
| Additional capital.....                    | 115,741,940                            | 632,020     | 116,373,960                           |
| Net assets at market or<br>fair value..... | \$724,557,938                          | \$1,173,751 | \$725,731,689                         |

## 8. Commitments

The Company has agreed, subject to certain conditions, to invest up to \$5,429,760 in 3 portfolio companies.

The Company leases office space under an operating lease which requires base annual rentals of approximately \$80,000 through February, 2013. For the three years ended March 31, total rental expense charged to investment income was \$80,569 in 2008, \$79,979 in 2007 and \$76,877 in 2006.

## 9. Sources of Income

Income was derived from the following sources:

| Years Ended<br>March 31                               | Investment Income |             |                 | Realized Gain<br>(Loss) on<br>Investments<br>Before Income<br>Taxes |
|---|-------------------|-------------|-----------------|---|
|   | Interest          | Dividends   | Other<br>Income |   |
| 2008  |                   |             |                 |   |
| Companies more than<br>25% owned .....                | \$ --             | \$2,979,631 | \$ 839,800      | \$ --   |
| Companies 5% to 25%<br>owned .....                    | 364,762           | 326,940     | 42,500          | --  |
| Companies less than<br>5% owned .....                 | 469,066           | 350,262     | --              | 240,024   |
| Other sources, including<br>temporary investments ... | 1,421,722         | --          | --              | --  |
|   | \$2,255,550       | \$3,656,833 | \$ 882,300      | \$ 240,024  |

| Years Ended<br>March 31                | Investment Income |              |                 | Realized Gain<br>(Loss) on<br>Investments<br>Before Income<br>Taxes |
|--|-------------------|--------------|-----------------|---|
|  | Interest          | Dividends    | Other<br>Income |   |
| 2007                                   |                   |              |                 |   |
| Companies more than<br>25% owned ..... | \$ --             | \$ 3,449,558 | \$ 659,500      | \$ 31,070,149   |
| Companies 5% to 25%<br>owned .....     | 125,733           | 171,578      | 20,000          | --  |
| Companies less than<br>5% owned .....  | 938,761           | 333,739      | 29,400          | (5,023,154)   |

|  |              |              |            |               |
|--|--------------|--------------|------------|---------------|
| Other sources,<br>including temporary<br>investments ..... | 1,244,166    | --           | --         | --            |
|  | -----        | -----        | -----      | -----         |
|  | \$ 2,308,660 | \$ 3,954,875 | \$ 708,900 | \$ 26,046,995 |
|  | =====        | =====        | =====      | =====         |

Investment Income  
-----

| Years Ended<br>March 31<br>-----                           |                   |                    | Other<br>Income | Realized Gain<br>(Loss) on<br>Investments<br>Before Income<br>Taxes |
|--|-------------------|--------------------|-----------------|---|
| 2006<br>----   | Interest<br>----- | Dividends<br>----- | -----           | -----   |
| Companies more than<br>25% owned .....                     | \$ --             | \$ 2,926,964       | \$ 642,500      | \$ --   |
| Companies 5% to 25<br>owned .....                          | (55,236)          | 188,233            | 10,000          | --  |
| Companies less than<br>5% owned .....                      | 302,622           | 370,233            | 195,570         | 20,278,566  |
| Other sources,<br>including temporary<br>investments ..... | 258,150           | --                 | --              | --  |
|  | -----             | -----              | -----           | -----   |
|  | \$ 505,536        | \$ 3,485,430       | \$ 848,070      | \$20,278,566  |
|  | =====             | =====              | =====           | =====   |

Selected Per Share Data and Ratios

|   | Years Ended March |          |          |          |          |
|---|-------------------|----------|----------|----------|----------|
|   | 2008              | 2007     | 2006     | 2005     | 2004     |
| <b>Per Share Data</b>   |                   |          |          |          |          |
| Investment income .....   | \$ 1.75           | \$ 1.79  | \$ 1.25  | \$ 1.26  | \$ 1.22  |
| Operating expenses .....  | (.76)             | (.57)    | (.51)    | (.51)    | (.39)    |
| Interest expense .....  | --                | (.12)    | (.11)    | (.11)    | (.14)    |
| Income taxes .....  | (.03)             | (.01)    | (.01)    | (.02)    | (.02)    |
| Net investment income .....   | .96               | 1.09     | .62      | .62      | .67      |
| Distributions from undistributed net investment income .....            | (.60)             | (.60)    | (.60)    | (.60)    | (.60)    |
| Net realized gain (loss) on investments .....                           | .06               | 3.85     | 4.00     | (2.62)   | 3.27     |
| Net increase (decrease) in unrealized appreciation of investments ..... | (36.76)           | 38.00    | 32.22    | 7.21     | 29.57    |
| Exercise of employee stock options* .....                               | (.09)             | (.49)    | (.04)    | --       | (.25)    |
| Stock option expense .....  | .07               | .04      | --       | --       | --       |
| Net change in pension plan funded status .....                          | (.30)             | --       | --       | --       | --       |
| Adjustment to initially apply FASB No. 158, net of tax .....            | --                | .30      | --       | --       | --       |
| Increase (decrease) in net asset value .....                            | (36.66)           | 42.19    | 36.20    | 4.61     | 32.66    |
| Net asset value   |                   |          |          |          |          |
| Beginning of year .....   | 186.75            | 144.56   | 108.36   | 103.75   | 71.09    |
| End of year .....   | \$150.09          | \$186.75 | \$144.56 | \$108.36 | \$103.75 |
|   | =====             | =====    | =====    | =====    | =====    |
| <b>Ratios and Supplemental Data</b>                                     |                   |          |          |          |          |
| Ratio of operating expenses to average net assets .....                 | .46%              | .36%     | .42%     | .49%     | .47%     |
| Ratio of net investment income to average net assets .....              | .58%              | .68%     | .51%     | .60%     | .81%     |
| Portfolio turnover rate .....   | .22%              | .13%     | 2.36%    | .56%     | 3.74%    |
| Net asset value total return .....                                      | 19.27%            | 29.85%   | 34.31%   | 5.25%    | 47.42%   |
| Shares outstanding at end of period (000s omitted) .....                | 3,889             | 3,886    | 3,860    | 3,857    | 3,857    |

\* Net decrease is due to the exercise of employee stock options at prices less than beginning of period net asset value.

## Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States.

Because of its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company has assessed the effectiveness of its internal control over financial reporting as of March 31, 2008. In making this assessment, it used the criteria described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management believes that, as of March 31, 2008, the Company's internal control over financial reporting was effective.

During the fiscal quarter ended March 31, 2008, the Company implemented the following control in order to remediate the material weakness we identified in our internal controls over accounting for taxes, which resulted in the restatement of our consolidated financial statements for the year ended March 31, 2007 and years represented in our Form 10-K for the year ended March 31, 2007.

o On a quarterly basis the Company will consult with a RIC compliance expert, on our current RIC status and the potential impact of proposed transactions and scenarios on the Company's future RIC compliance status. The Company has engaged KPMG, LLP to serve in this capacity.

There were no other changes to our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

Grant Thornton LLP, the independent registered public accounting firm that audited our consolidated financial statements included in this annual report on Form 10-K for the year ended March 31, 2008, has issued an attestation report on our internal control over financial reporting as of March 31, 2008. That report appears on the next page.

*Date: May 23, 2008*

*/s/ Gary L. Martin*

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*Gary L. Martin*  
*President & Chief Executive Officer*

*/s/ Tracy L. Morris*

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*Tracy L. Morris*  
*Controller*  
*(chief financial/accounting officer)*

## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders  
Capital Southwest Corporation

We have audited Capital Southwest Corporation (a Texas Corporation) and subsidiaries', (the "Company") internal control over financial reporting as of March 31, 2008, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2008, based on criteria established in Internal Control--Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial condition of the Company as of March 31, 2008 and 2007, including the portfolio of investments as of March 31, 2008, and the related consolidated statements of operations, changes in net assets, cash flows, and the selected per share data and ratios for each of the three years in the period ended March 31, 2008, and our report dated May 23, 2008 expressed an unqualified opinion.

*/s/Grant Thornton LLP*

*Dallas, Texas  
May 23, 2008*

## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders  
Capital Southwest Corporation

We have audited the accompanying consolidated statements of financial condition of Capital Southwest Corporation (a Texas Corporation) and subsidiaries (the "Company") as of March 31, 2008 and 2007, including the portfolio of investments as of March 31, 2008, and the related consolidated statements of operations, changes in net assets, cash flows for each of the three years in the period ended March 31, 2008, and the selected per share data and ratios for each of the four years in the period ended March 31, 2008. These financial statements and per share data and ratios are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and per share data and ratios based on our audits. The selected per share data and ratios for the year ended March 31, 2004, were audited by another independent registered public accounting firm whose report dated May 12, 2004, except for Note 2, which is as of January 9, 2008 expressed an unqualified opinion.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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 verification by examination of securities held by the custodian as of March 31, 2008 and 2007, and confirmation of securities not held by the custodian. 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.

In our opinion, the consolidated financial statements and the selected per share data and ratios referred to above present fairly, in all material respects, the consolidated financial position of Capital Southwest Corporation and subsidiaries as of March 31, 2008 and 2007, and the consolidated results of its operations, changes in its net assets, its cash flows for each of the three years in the period ended March 31, 2008, and the selected per share data and ratios for each of the four years in the period ended March 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 5 to the consolidated financial statements, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, effective April 1, 2006. As described in Note 7 to the consolidated financial statements, the Company also adopted the provisions of FASB Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans: An Amendment of FASB Statements No. 87, 88, 106, and 132(R), effective March 31, 2008.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Capital Southwest Corporation and subsidiaries' internal control over financial reporting as of March 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated May 23, 2008, expressed an unqualified opinion thereon.

*/s/Grant Thornton LLP*

*Dallas, Texas  
May 23, 2008*

## Results of Operations

The composite measure of the Company's financial performance in the Consolidated Statements of Operations is captioned "Increase in net assets from operations" and consists of three elements. The first is "Net investment income," which is the difference between the Company's income from interest, dividends and fees and its combined operating and interest expenses, net of applicable income taxes. The second element is "Net realized gain (loss) on investments," which is the difference between the proceeds received from disposition of portfolio securities and their stated cost, net of applicable income tax expense based on the Company's tax year. The third element is the "Net increase in unrealized appreciation of investments," which is the net change in the market or fair value of the Company's investment portfolio, compared with stated cost. It should be noted that the "Net realized gain (loss) on investments" and "Net increase in unrealized appreciation of investments" are directly related in that when an appreciated portfolio security is sold to realize a gain, a corresponding decrease in net unrealized appreciation occurs by transferring the gain associated with the transaction from being "unrealized" to being "realized." Conversely, when a loss is realized on a depreciated portfolio security, an increase in net unrealized appreciation occurs.

### Net Investment Income

The Company's principal objective is to achieve capital appreciation. Therefore, a significant portion of the investment portfolio is structured to maximize the potential return from equity participation and provides minimal current yield in the form of interest or dividends. The Company also earns interest income from the short-term investment of cash funds, and the annual amount of such income varies based upon the average level of funds invested during the year and fluctuations in short-term interest rates. During the three years ended March 31, the Company had interest income from temporary cash investments of \$1,421,048 in 2008, \$1,187,676 in 2007 and \$257,374 in 2006. The Company also receives management fees primarily from its wholly-owned portfolio companies which aggregated \$784,800 in 2008, \$626,400 in 2007 and \$792,570 in 2006. During the three years ended March 31, 2008, the Company recorded dividend income from the following sources:

|                                      | Years Ended March 31 |             |             |
|--------------------------------------|----------------------|-------------|-------------|
|                                      | 2008                 | 2007        | 2006        |
| Alamo Group Inc. ....                | \$ 678,732           | \$ 677,112  | \$ 677,112  |
| Balco, Inc. ....                     | 224,400              | --          | 252,960     |
| Dennis Tool Company.....             | 62,499               | 62,499      | 49,999      |
| Encore Wire Corporation.....         | 326,940              | --          | --          |
| Kimberly-Clark Corporation.....      | 167,481              | 154,360     | 142,011     |
| Lifemark Group.....                  | 571,333              | 600,000     | 600,000     |
| PalletOne, Inc.....                  | --                   | 89,842      | 179,685     |
| The RectorSeal Corporation.....      | 1,154,133            | 1,869,947   | 1,106,893   |
| Sprint Nextel Corporation.....       | 6,750                | 9,000       | 18,000      |
| TCI Holdings, Inc.....               | 81,270               | 81,270      | 81,270      |
| The Whitmore Manufacturing Company.. | 288,533              | 240,000     | 240,000     |
| Other.....                           | 94,762               | 170,845     | 137,500     |
|                                      | -----                | -----       | -----       |
|                                      | \$3,656,833          | \$3,954,875 | \$3,485,430 |
|                                      | =====                | =====       | =====       |

Total operating expenses, excluding interest expense, increased by \$742,951 or 33.4% during the year ended March 31, 2008. Due to the nature of its business, the majority of the Company's operating expenses are related to employee and director compensation, office expenses, legal, professional and accounting fees and the net pension benefit.

### Net Realized Gain (Loss) on Investments

Net realized gain on investments was \$240,024 during the year ended March 31, 2008, compared with a gain of \$14,966,296 (after income tax expense of

\$11,080,699) during 2007 and a gain of \$15,450,903 (after income tax of \$4,827,663) during 2006. Management does not attempt to maintain a comparable level of realized gains from year to year, but instead attempts to maximize total investment portfolio appreciation. This strategy often dictates the long-term holding of portfolio securities in pursuit of increased values and increased unrealized appreciation, but may at opportune times dictate realizing gains or losses through the disposition of certain portfolio investments.

### Net Increase in Unrealized Appreciation of Investments

For the three years ended March 31, the Company recorded a decrease in unrealized appreciation of investments of \$142,969,698, in 2008 and an increase of \$147,681,609 and \$124,355,303, in 2007 and 2006, respectively. As explained in the first paragraph of this discussion and analysis, the realization of gains or losses results in a corresponding decrease or increase in unrealized appreciation of investments. Set forth in the following table are the significant increases and decreases in unrealized appreciation excluding the effect of gains or losses realized during the year by portfolio company for securities held at the end of each year.

|   | Years Ended March 31 |              |                |
|---|----------------------|--------------|----------------|
|   | 2008                 | 2007         | 2006           |
| Alamo Group Inc. ....                   | \$ (2,803,090)       | \$ 2,821,000 | \$ (5,642,000) |
| Encore Wire Corporation.....            | (18,390,625)         | (12,260,000) | 49,041,000     |
| Heelys, Inc.....                        | (160,724,088)        | 170,040,908  | 27,000,000     |
| The Whitmore Manufacturing Company..... | 12,000,000           | 4,000,000    | 4,000,000      |
| Lifemark Group.....                     | 31,000,000           | (2,000,000)  | 2,000,000      |
| Media Recovery, Inc.....                | (7,500,000)          | 3,000,000    | 15,744,000     |
| Palm Harbor Homes, Inc.....             | (39,275,516)         | (27,493,000) | 27,493,000     |
| The RectorSeal Corporation.....         | 46,200,000           | 10,500,000   | 15,000,000     |

As shown in the table above for the year ended March 31, 2008, we sustained major increases in The RectorSeal Corporation, LifeMark Group and The Whitmore Manufacturing Company. The \$46,200,000 increase in RectorSeal and the \$12,000,000 increase in Whitmore were attributable to strong earnings derived from organic growth and the performance of recent acquisitions. LifeMark Group's \$31,000,000 increase is attributable to an increase in value of its cemetery and funeral home operations including the new Lifemark Center Funeral Home and continued escalations in non-business land values.

Offsetting these major increases were significant decreases in Heely's, Inc., Palm Harbor Homes, Inc., and Encore Wire Corporation. While the Heely's investment represented our largest holding at March 31, 2007, the market for Heely's stock declined during the year to a level that decreased our value by \$160,724,088. Palm Harbor's decrease of \$39,275,516 is attributable to several financial setbacks as the residual real estate markets eroded during the year. Additionally, Encore Wire experienced adversity related to the eroding residual markets and severe competition that had negative impact on its market price prompting us to decrease our value by \$18,390,625.

A description of the investments listed above and other material components of the investment portfolio is included elsewhere in this report under the caption "Portfolio of Investments - March 31, 2008."

### Portfolio Investments

During the year ended March 31, 2008, the Company invested \$10,733,536 in various portfolio securities listed elsewhere in this report under the caption "Portfolio Changes During the Year," which also lists dispositions of portfolio securities. During the 2007 and 2006 fiscal years, the Company invested a total of \$803,269 and \$15,054,741, respectively.

### Financial Liquidity and Capital Resources

At March 31, 2008, the Company had cash and cash equivalents of approximately \$31.3 million. Pursuant to Small Business Administration (SBA) regulations, cash and cash equivalents of \$4.7 million held by CSVC may not be transferred or

advanced to CSC without the consent of the SBA. Under current SBA regulations and subject to the SBA's approval of its credit application, CSVC would be entitled to borrow up to \$16.4 million.

With the exception of a capital gain distribution made in the form of a distribution of the stock of a portfolio company in the fiscal year ended March 31, 1996, the Company has elected to retain all gains realized during the past 39 years. Retention of future gains is viewed as an important source of funds to sustain the Company's investment activity. Approximately \$52.7 million of the Company's investment portfolio is represented by unrestricted publicly-traded securities and represent a source of liquidity.

Funds to be used by the Company for operating or investment purposes may be transferred in the form of dividends, management fees or loans from Lifemark Group, The RectorSeal Corporation and The Whitmore Manufacturing Company, wholly-owned portfolio companies of the Company, to the extent of their available cash reserves and borrowing capacities.

Management believes that the Company's cash and cash equivalents and cash available from other sources described above are adequate to meet its expected requirements. Consistent with the long-term strategy of the Company, the disposition of investments from time to time may also be an important source of funds for future investment activities.

### Contractual Obligations

As shown below, the Company had the following contractual obligations as of March 31, 2008. For further information see Note 8 of the Consolidated Financial Statements.

| Contractual Obligations     | Payments Due By Period (\$ in Thousands) |                     |              |              |                      |
|-----------------------------|--|---------------------|--------------|--------------|----------------------|
|                             | Total                                    | Less than<br>1 Year | 1-3<br>Years | 3-5<br>Years | More Than<br>5 Years |
| Operating lease obligations | \$393                                    | \$80                | \$240        | \$73         | --                   |
| Total                       | \$393                                    | \$80                | \$240        | \$73         | --                   |

### Critical Accounting Policies

### Valuation of Investments

In accordance with the Investment Company Act of 1940, investments in unrestricted securities (freely marketable securities having readily available market quotations) are valued at market and investments in restricted securities (securities subject to one or more resale restrictions) are valued at fair value determined in good faith by the Company's Board of Directors. Under the valuation policy of the Company, unrestricted securities are valued at the closing sale price for NYSE listed securities and at the lower of the closing bid price or the last sale price for Nasdaq securities on the valuation date. Restricted securities, including securities of publicly-owned companies which are subject to restrictions on resale, are valued at fair value, which is considered to be the amount the Company may reasonably expect to receive if such securities were sold on the valuation date. Valuations as of any particular date, however, are not necessarily indicative of amounts which may ultimately be realized as a result of future sales or other dispositions of securities.

Among the factors considered by the Board of Directors in determining the fair value of restricted securities are the financial condition and operating results of the issuer, the long-term potential of the business of the issuer, the market for and recent sales prices of the issuer's securities, the values of similar securities issued by companies in similar businesses, the proportion of the issuer's securities owned by the Company, the nature and duration of resale restrictions and the nature of any rights enabling the Company to require the issuer to register restricted securities under applicable securities laws.

### **Impact of Inflation**

The Company does not believe that its business is materially affected by inflation, other than the impact which inflation may have on the securities markets, the valuations of business enterprises and the relationship of such valuations to underlying earnings, all of which will influence the value of the Company's investments.

### **Risks**

Pursuant to Section 64(b)(1) of the Investment Company Act of 1940, a business development company is required to describe the risk factors involved in an investment in the securities of such company due to the nature of the company's investment portfolio. Accordingly the Company states that:

The Company's objective is to achieve capital appreciation through investments in businesses believed to have favorable growth potential. Such businesses are often undercapitalized small companies which lack management depth and have not yet attained profitability. The Company's venture investments often include securities which do not yield interest or dividends and are subject to legal or contractual restrictions on resale, which restrictions adversely affect the liquidity and marketability of such securities.

Because of the speculative nature of the Company's investments and the lack of any market for the securities initially purchased by the Company, there is a significantly greater risk of loss than is the case with traditional investment securities. The high-risk, long-term nature of the Company's venture investment activities may prevent shareholders of the Company from achieving price appreciation and dividend distributions.

Selected Consolidated Financial Data  
(all figures in thousands except per share data)

|   | 1998      | 1999      | 2000      | 2001      | 2002      | 2003      | 2004      |
|---|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| <b>Financial Position (as of March 31)</b>  |           |           |           |           |           |           |           |
| Investments at cost .....   | \$ 61,154 | \$ 73,580 | \$ 85,002 | \$ 87,602 | \$ 82,194 | \$ 91,462 | \$ 97,283 |
| Unrealized appreciation .....   | 340,132   | 276,698   | 238,627   | 228,316   | 265,287   | 195,598   | 309,666   |
| Investments at market or<br>fair value .....  | 401,286   | 350,278   | 323,629   | 315,918   | 347,481   | 287,060   | 406,949   |
| Total assets .....  | 522,324   | 360,786   | 392,586   | 322,668   | 357,183   | 298,490   | 423,979   |
| Notes payable * .....   | 5,000     | 5,000     | 10,000    | 16,000    | 14,000    | 23,000    | 20,500    |
| Net assets .....  | 414,697   | 352,974   | 319,438   | 303,436   | 339,891   | 272,211   | 400,157   |
| Shares outstanding .....  | 3,788     | 3,815     | 3,815     | 3,815     | 3,829     | 3,829     | 3,857     |
| <b>Changes in Net Assets (years ended March 31)</b>                                 |           |           |           |           |           |           |           |
| Net investment income .....   | \$ 2,726  | \$ 1,762  | \$ 1,663  | \$ 1,723  | \$ 2,042  | \$ 2,299  | \$ 2,587  |
| Net realized gain (loss) on<br>investments .....                                    | 3,301     | 1,264     | 5,162     | (5,126)   | (762)     | 2,007     | 12,603    |
| Net increase (decrease) in<br>unrealized appreciation<br>before distributions ..... | 106,749   | (63,434)  | (38,072)  | (10,311)  | 36,971    | (69,689)  | 114,068   |
| Increase (decrease) in net<br>assets from operations<br>before distributions .....  | 112,776   | (60,408)  | (31,247)  | (13,714)  | 38,251    | (65,383)  | 129,258   |
| Cash dividends paid .....   | (2,268)   | (2,280)   | (2,289)   | (2,289)   | (2,295)   | (2,297)   | (2,309)   |
| Employee stock options<br>exercised .....   | 720       | 965       | --        | --        | 499       | --        | 997       |
| Stock option expense .....  | --        | --        | --        | --        | --        | --        | --        |
| Change in pension plan<br>funded status .....                                       | --        | --        | --        | --        | --        | --        | --        |
| Adjustment to initially apply FASB<br>Statement No. 158, net of tax ....            | --        | --        | --        | --        | --        | --        | --        |
| Increase (decrease) in net assets ...   | 111,228   | (61,723)  | (33,536)  | (16,003)  | 36,455    | (67,680)  | 127,946   |
| <b>Per Share Data (as of March 31)</b>  |           |           |           |           |           |           |           |
| Net assets.....   | \$ 109.48 | \$ 92.52  | \$ 83.73  | \$ 79.54  | \$ 88.77  | \$ 71.09  | \$ 103.75 |
| Closing market price.....   | 94.00     | 73.00     | 54.75     | 65.00     | 68.75     | 48.15     | 75.47     |
| Cash dividends paid.....  | .60       | .60       | .60       | .60       | .60       | .60       | .60       |

o Excludes quarter-end borrowing which is repaid on the first business day after year end.

Selected Consolidated Financial Data  
(all figures in thousands except per share data)

|   | 2005      | 2006      | 2007      | 2008      |
|---|-----------|-----------|-----------|-----------|
| -----   |           |           |           |           |
| Financial Position (as of March 31)   |           |           |           |           |
| Investments at cost .....   | \$ 84,546 | \$ 88,597 | \$ 71,642 | \$ 81,027 |
| Unrealized appreciation .....   | 337,476   | 461,831   | 609,513   | 466,544   |
| -----   |           |           |           |           |
| Investments at market or<br>fair value .....  | 422,022   | 550,428   | 681,155   | 547,571   |
| Total assets .....  | 434,384   | 569,368   | 729,507   | 586,685   |
| Notes payable * .....   | 13,000    | 8,000     | --        | --        |
| Net assets .....  | 417,947   | 558,036   | 725,732   | 583,700   |
| Shares outstanding .....  | 3,857     | 3,860     | 3,886     | 3,889     |
| -----   |           |           |           |           |
| Changes in Net Assets (years ended March 31)  |           |           |           |           |
| Net investment income .....   | \$ 2,406  | \$ 2,389  | \$ 4,233  | \$ 3,715  |
| Net realized gain (loss) on<br>investments .....                                    | (10,112)  | 15,451    | 14,966    | 240       |
| Net increase (decrease) in<br>unrealized appreciation<br>before distributions ..... | 27,810    | 124,355   | 147,682   | (142,969) |
| -----   |           |           |           |           |
| Increase (decrease) in net<br>assets from operations<br>before distributions .....  | 20,104    | 142,195   | 166,881   | (139,014) |
| Cash dividends paid .....   | (2,314)   | (2,314)   | (2,323)   | (2,333)   |
| Employee stock options<br>exercised .....   | --        | 208       | 1,795     | 231       |
| Stock option expense .....  | --        | --        | 169       | 263       |
| Change in pension plan<br>funded status .....                                       | --        | --        | --        | (1,178)   |
| Adjustment to initially apply FASB<br>Statement No. 158, net of tax .....           | --        | --        | 1,173     | --        |
| -----   |           |           |           |           |
| Increase (decrease) in net assets .....   | 17,790    | 140,089   | 167,695   | (142,031) |
| -----   |           |           |           |           |
| Per Share Data (as of March 31)   |           |           |           |           |
| Net assets.....   | \$ 108.36 | \$ 144.56 | \$ 186.75 | \$ 150.09 |
| Closing market price.....   | 79.10     | 95.50     | 153.67    | 123.72    |
| Cash dividends paid.....  | .60       | .60       | .60       | .60       |

o Excludes quarter-end borrowing which is repaid on the first business day after year end.

## Shareholder Information

### Stock Transfer Agent

American Stock Transfer & Trust Company, 59 Maiden Lane, New York, NY 10038 (telephone 800-937-5449) serves as transfer agent for the Company's common stock. Certificates to be transferred should be mailed directly to the transfer agent, preferably by registered mail.

### Shareholders

The Company had approximately 700 record holders of its common stock at March 31, 2008. This total does not include an estimated 4,000 shareholders with shares held under beneficial ownership in nominee name or within clearinghouse positions of brokerage firms or banks.

### Market Prices

The Company's common stock trades on The Nasdaq Global Market under the symbol CSWC. The following high and low selling prices for the shares during each quarter of the last two fiscal years were taken from quotations provided to the Company by Nasdaq:

| Quarter Ended           | High     | Low      |
|-------------------------|----------|----------|
| June 30, 2006.....      | \$104.45 | \$ 90.65 |
| September 30, 2006..... | 121.00   | 96.47    |
| December 31, 2006.....  | 154.36   | 115.33   |
| March 31, 2007.....     | 155.99   | 122.05   |
| Quarter Ended           | High     | Low      |
| June 30, 2007.....      | \$190.33 | \$144.50 |
| September 30, 2007..... | 162.13   | 110.00   |
| December 31, 2007.....  | 130.00   | 105.16   |
| March 31, 2008.....     | 127.49   | 100.00   |

### Dividends

The payment dates and amounts of cash dividends per share since April 1, 2006 are as follows:

| Payment Date           | Cash Dividend |
|------------------------|---------------|
| May 31, 2006.....      | \$0.20        |
| November 30, 2006..... | 0.40          |
| May 31, 2007.....      | 0.20          |
| November 30, 2007..... | 0.40          |
| May 31, 2008.....      | 0.40          |

The amounts and timing of cash dividend payments have generally been dictated by requirements of the Internal Revenue Code regarding the distribution of taxable net investment income (ordinary income) of regulated investment companies. Instead of distributing realized long-term capital gains to shareholders, the Company has ordinarily elected to retain such gains to fund future investments.

### Automatic Dividend Reinvestment and Optional Cash Contribution Plan

As a service to its shareholders, the Company offers an Automatic Dividend Reinvestment and Optional Cash Contribution Plan for shareholders of record who own a minimum of 25 shares. The Company pays all costs of administration of the Plan except brokerage transaction fees. Upon request, shareholders may obtain information on the Plan from the Company, 12900 Preston Road, Suite 700, Dallas, Texas 75230. Telephone (972) 233-8242. Questions and answers about the Plan are on the next page.

### Annual Meeting

The Annual Meeting of Shareholders of Capital Southwest Corporation will be held on Monday, July 21, 2008, at 10:00 a.m. in the North Dallas Bank Tower Meeting Room (second floor), 12900 Preston Road, Dallas, Texas.

**Exhibit 21.1**

**CAPITAL SOUTHWEST CORPORATION**

**List of Subsidiaries**

| Name of Subsidiary<br>-----                   | State of Incorporation<br>----- |
|---|---------------------------------|
| All Components, Inc.                          | Nevada                          |
| Balco, Inc.                                   | Delaware                        |
| Humac Company                                 | Texas                           |
| Media Recovery, Inc.                          | Nevada                          |
| The RectorSeal Corporation                    | Delaware                        |
| Lifemark Group (formerly Skylawn Corporation) | Nevada                          |
| The Whitmore Manufacturing Company            | Delaware                        |

**EXHIBIT 23.1**

**Consent of Independent Registered Public Accounting Firm**

We have issued our reports dated May 23, 2008, with respect to the consolidated financial statements and internal control over financial reporting included in the Annual Report of Capital Southwest Corporation and subsidiaries on Form 10-K for the year ended March 31, 2008. We hereby consent to the incorporation by reference of said reports in the Registration Statement of Capital Southwest Corporation and subsidiaries on Form S-8 (File No. 33-43881).

*/s/ GRANT THORNTON LLP*

*Dallas, Texas  
May 23, 2008*

**Exhibit 31.1**

**CERTIFICATIONS**

I, Gary L. Martin certify that:

1. I have reviewed this annual report on Form 10-K of Capital Southwest Corporation (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

*Date: May 23, 2008*

*By: /s/ Gary L. Martin  
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Gary L. Martin, President*

**Exhibit 31.2**

**CERTIFICATIONS**

I, Tracy L. Morris certify that:

1. I have reviewed this annual report on Form 10-K of Capital Southwest Corporation (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

*Date: May 23, 2008*

*By: /s/Tracy L. Morris*

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*Tracy L. Morris, Controller*

Exhibit 32.1

Certification of President

Pursuant to 18 U.S.C. Section, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

I, Gary L. Martin, President of Capital Southwest Corporation, certify that, to my knowledge:

1. The Form 10-K, filed with the Securities and Exchange Commission on May 23, 2008 ("accompanied report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the accompanied report fairly presents, in all material respects, the consolidated financial condition and results of operations of Capital Southwest Corporation.

*Date: May 23, 2008*

*By: /s/ Gary L. Martin*

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*Gary L. Martin, President*

Exhibit 32.2

Certification of Controller

Pursuant to 18 U.S.C. Section, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

I, Tracy L. Morris, Controller of Capital Southwest Corporation, certify that, to my knowledge:

1. The Form 10-K, filed with the Securities and Exchange Commission on May 23, 2008 ("accompanied report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the accompanied report fairly presents, in all material respects, the consolidated financial condition and results of operations of Capital Southwest Corporation.

*Date: May 23, 2008*

*/s/ Tracy L. Morris*

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*Tracy L. Morris, Controller*