

CAPITAL SOUTHWEST CORP

FORM 10-K (Annual Report)

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

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, 2006

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 X

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 X

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

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

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 X 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, 2005 was \$166,318,187, based on the last sale price of such stock as quoted by Nasdaq on such date (officers, directors and 5% shareholders are considered affiliates for purposes of this calculation).

The number of shares of common stock outstanding as of May 15, 2006 was 3,860,251.

Documents Incorporated by Reference -----	Part of Form 10-K -----
(1) Annual Report to Shareholders for the Year Ended March 31, 2006	Parts I and II; and Part IV, Item 15(a)(1) and (2)
(2) Proxy Statement for Annual Meeting of Shareholders to be held July 17, 2006	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. The 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 twelve largest investments we own had a combined cost of \$36,296,096 and a value of \$494,505,176, representing 89.8% of the value of our consolidated investment portfolio at March 31, 2006. For a narrative description of the twelve largest investments, see "Twelve Largest Investments - March 31, 2006" on pages 9 through 11 of our Annual Report to Shareholders for the Year Ended March 31, 2006 (our "2006 Annual Report") which is herein incorporated by reference. Certain of the information presented on the twelve 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 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, 2006 was seven.

Our internet website address is 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 before making a decision to purchase our common stock. 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 which would be applicable to unrestricted securities having a public market.

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. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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. 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 stockholders. 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.

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 with a number of private equity funds, other investment entities and individuals for investment opportunities. 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.

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 Stock Market ("NASDAQ"). Stockholders 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.

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 3,700 square feet of office space pursuant to a lease agreement expiring in February 2008. We believe that our offices are adequate to meet our current and expected future needs.

Item 3. Legal Proceedings

We have no material pending legal proceedings to which we are a party or to which any of our property is subject.

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, 2006.

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" on page 38 of our 2006 Annual Report is herein incorporated by reference.

Item 6. Selected Financial Data

"Selected Consolidated Financial Data" on page 37 of our 2006 Annual Report is herein incorporated by reference.

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

Pages 34 through 36 of our 2006 Annual Report are herein incorporated by reference.

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 \$10,335,871 at March 31, 2006, equivalent to 1.9% 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

Pages 12 through 33 of our 2006 Annual Report are herein incorporated by reference. See also 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, 2006 and 2005.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
(In thousands, except per share amounts)					
2006					
Net investment income	\$ 574	\$ 666	\$ 893	\$ 256	\$ 2,389
Net realized gain on investments	3,409	3,772	4,132	1,803	13,116
Net increase in unrealized appreciation of investments	2,692	17,436	9,755	46,521	80,685
Net increase in net assets from operations	6,675	21,874	14,780	48,580	96,190
Net increase in net assets from operations per share	1.73	5.67	3.83	12.58	24.92
2005					
Net investment income	\$ 489	\$ 443	\$ 1,366	\$ 108	\$ 2,406
Net realized gain (loss) on investments	(1,556)	(2,470)	(3,422)	1,382	(6,066)
Net increase (decrease) in unrealized appreciation of investments	(2,392)	(2,547)	15,025	7,799	17,885
Net increase (decrease) in net assets from operations	(3,459)	(4,574)	12,969	9,289	14,225
Net increase (decrease) in net assets from operations per share	(0.90)	(1.18)	3.36	2.41	3.69

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

None.

Item 9A. Controls and Procedures

As of March 31, 2006, an evaluation was performed under the supervision and with the participation of our management, including the President and Chairman of the Board and Secretary-Treasurer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934). Based on that evaluation, the President and Chairman of the Board and Secretary-Treasurer concluded that our disclosure controls and procedures are effective to ensure that the information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and is accumulated and communicated to management, including the President and Chairman of the Board and Secretary-Treasurer, as appropriate, to allow timely decisions regarding such required disclosure.

During the fiscal quarter ended March 31, 2006, there were no changes to the internal control over financial reporting that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

The section of our 2006 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 1, 2006, together with certain biographical information, are as follows:

William M. Ashbaugh, age 51, 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.

Susan K. Hodgson, age 44, has served as Secretary-Treasurer since 2001 and was Controller from 1994 to 2001.

Gary L. Martin, age 59, 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 32, 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.

William R. Thomas, age 77, has served as Chairman of the Board of Directors since 1982 and President since 1980. In addition, he has been a director since 1972 and was previously Senior Vice President from 1969 to 1980.

One of our executive officers, Patrick F. Hamner, Senior Vice President, resigned on May 18, 2006.

The sections of our 2006 Proxy Statement captioned "Meetings and Committees of the Board of Directors - Audit Committee" 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 2006 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.

Item 11. Executive Compensation

The information in the section of our 2006 Proxy Statement captioned "Executive Compensation" is incorporated in this Item 11 by reference.

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

The information in the sections of our 2006 Proxy Statement captioned "Stock Ownership of Certain Beneficial Owners" and "Executive Compensation" are incorporated in this Item 12 by reference.

The table below sets forth certain information as of March 31, 2006 regarding the shares of our common stock available for grant or granted under stock option plans that (i) were approved by our stockholders, and (ii) were not approved by our stockholders.

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 (excluding securities reflected in column (a))
-----	(a) ---	(b) ---	(c) ---
Equity compensation plans approved by security holders(1)	45,300	\$68.411	91,500
Equity compensation plans not approved by security holders	-	-	-
Total	----- 45,300	----- \$68.411	----- 91,500

(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

There were no relationships or transactions within the meaning of this item during the fiscal year ended March 31, 2006 or proposed for the fiscal year ending March 31, 2007.

Item 14. Principal Accountant Fees and Services

The information in the sections of our 2006 Proxy Statement captioned "Proposal 2: Ratification of Appointment of Independent Auditors" 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 pages 12 through 33 of our 2006 Annual Report are herein incorporated by reference:

(A) Portfolio of Investments - March 31, 2006 Consolidated Statements of Financial Condition - March 31, 2006 and 2005
Consolidated Statements of Operations - Years Ended March 31, 2006, 2005 and 2004
Consolidated Statements of Changes in Net Assets - Years Ended March 31, 2006, 2005 and 2004 Consolidated Statements of Cash Flows -
Years Ended March 31, 2006, 2005 and 2004

(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 Firms

(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/ William R. Thomas

William R. Thomas, President
and Chairman of the Board

Date: May 26, 2006

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

Signature Title Date

/s/ William R. Thomas ----- William R. Thomas	President and Chairman of the Board and Director (chief executive officer)	May 26, 2006
/s/ Gary L. Martin ----- Gary L. Martin	Director	May 26, 2006
/s/ Graeme W. Henderson ----- Graeme W. Henderson	Director	May 26, 2006
/s/ Samuel B. Ligon ----- Samuel B. Ligon	Director	May 26, 2006
/s/ John H. Wilson ----- John H. Wilson	Director	May 26, 2006
/s/ Susan K. Hodgson ----- Susan K. Hodgson	Secretary-Treasurer (chief financial/accounting officer)	May 26, 2006

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. -----	Description -----
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 (filed as Exhibit 2 to Amendment No. 11 to Form N-2 for the fiscal year ended March 31, 1987).
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, 1998 (filed as Exhibit 10.1 to Form 10-K for the fiscal year ended March 31, 2002).
10.2	Amendment No. 1 to The RectorSeal Corporation and Jet-Lube, Inc. Employee Stock Ownership Plan as revised and restated effective April 1, 1998 (filed as Exhibit 10.2 to Form 10-K for the fiscal year ended March 31, 2002).
10.3	Amendment No. 2 to The RectorSeal Corporation and Jet-Lube, Inc. Employee Stock Ownership Plan as revised and restated effective April 1, 1998 (filed as Exhibit 10.3 to Form 10-K for the fiscal year ended March 31, 2003).
10.4	Amendment No. 3 to The RectorSeal Corporation and Jet-Lube, Inc. Employee Stock Ownership Plan as revised and restated effective April 1, 1998 (filed as Exhibit 10.4 to Form 10-K for the fiscal year ended March 31, 2005).
10.5	Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates as amended and restated effective April 1, 1989 (filed as Exhibit 10.3 to Form 10-K for the fiscal year ended March 31, 1995).
10.6	Amendments One and Two to Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates as amended and restated effective April 1, 1989 (filed as Exhibit 10.4 to Form 10-K for the fiscal year ended March 31, 1998).
10.7	Amendment Three to Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates as amended and restated effective April 1, 1989 (filed as Exhibit 10.5 to Form 10-K for the fiscal year ended March 31, 2002).
10.8	Amendment Four to Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates as amended and restated effective April 1, 1989 (filed as Exhibit 10.7 to Form 10-K for the fiscal year ended March 31, 2003).

- 10.9 Amendment Five to Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates as amended and restated effective April 1, 1989 (filed as Exhibit 10.8 to Form 10-K for the fiscal year ended March 31, 2003).
- 10.10 Amendment Six to Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates as amended and restated effective April 1, 1989 (filed as Exhibit 10.9 to Form 10-K for the fiscal year ended March 31, 2003).
- 10.11 Amendment Seven to Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates as amended and restated effective April 1, 1989 (filed as Exhibit 10.11 to Form 10-K for the fiscal year ended March 31, 2005).
- 10.12 Amendment Eight to Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates as amended and restated effective April 1, 1989 (filed as Exhibit 10.12 to Form 10-K for the fiscal year ended March 31, 2005).
- 10.13 Amendment Nine to Retirement Plan for Employees of Capital Southwest Corporation and Its Affiliates as amended and restated effective April 1, 1989 (filed as Exhibit 10.13 to Form 10-K for the fiscal year ended March 31, 2005).
- 10.14 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).
- 10.15 Amendment One to 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 10.6 to Form 10-K for the fiscal year ended March 31, 1998).
- 10.16 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).
- 10.17 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).
- 10.18 Capital Southwest Corporation 1999 Stock Option Plan (filed as Exhibit 10.10 to Form 10-K for the fiscal year ended March 31, 2000).
- 10.19 Severance Pay Agreement with William M. Ashbaugh (filed as Exhibit 10.1 to Form 8-K dated July 18, 2005).
- 10.20 Severance Pay Agreement with Patrick F. Hamner (filed as Exhibit 10.2 to Form 8-K dated July 18, 2005).
- 10.21 Severance Pay Agreement with Susan K. Hodgson (filed as Exhibit 10.3 to Form 8-K dated July 18, 2005).
- 10.22 Severance Pay Agreement with Jeffrey G. Peterson (filed as Exhibit 10.4 to Form 8-K dated July 18, 2005).

- 13.1 * Annual Report to Shareholders for the fiscal year ended March 31, 2006.
- 21.1 * List of subsidiaries of the Company.
- 23.1 * Consent of Independent Registered Public Accounting Firm - Grant Thornton LLP.
- 23.2 * Consent of Independent Registered Public Accounting Firm - Ernst & Young LLP.
- 31.1 * Certification of President and Chairman of the Board 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 Secretary-Treasurer required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act, filed herewith.
- 32.1 ** Certification of President and Chairman of the Board 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 Secretary-Treasurer 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 13.1 Twelve Largest Investments - March 31, 2006

Palm Harbor Homes, Inc. \$98,189,000

Palm Harbor Homes, Dallas, Texas, is an integrated manufacturer and retailer of manufactured and modular housing produced in 19 plants and sold in 32 states by 116 company-owned retail stores and builder locations and approximately 350 independent dealers, builders and developers. The company provides financing through its 80% owned subsidiary, CountryPlace Mortgage, and sells insurance through its subsidiary, Standard Casualty. Palm Harbor's traditional manufactured homes and the upscale modular homes are designed to meet the need for attractive, affordable housing.

During the year ended March 31, 2006, Palm Harbor reported net income of \$11,114,000 (\$0.49 per share) on net sales of \$710,635,000, compared with a net loss of \$3,823,000 (\$0.17 per share) on net sales of \$610,538,000 in the previous year. The March 31, 2006 closing Nasdaq bid price of Palm Harbor's common stock was \$21.31 per share.

At March 31, 2006, the \$10,931,955 investment in Palm Harbor by Capital Southwest and its subsidiary was valued at \$98,189,000 (\$12.50 per share), consisting of 7,855,121 restricted shares of common stock, representing a fully-diluted equity interest of 30.5%.

The RectorSeal Corporation \$87,500,000

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 owns a 20% equity interest in The Whitmore Manufacturing Company (described on page 10).

During the year ended March 31, 2006, RectorSeal earned \$8,655,000 on revenues of \$95,060,000, compared with earnings of \$7,598,000 on revenues of \$76,072,000 in the previous year. RectorSeal's earnings do not reflect its 20% equity in The Whitmore Manufacturing Company.

At March 31, 2006, Capital Southwest owned 100% of RectorSeal's common stock having a cost of \$52,600 and a value of \$87,500,000.

Encore Wire Corporation \$81,735,000

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 and also armored cable for residential, commercial and industrial construction. Encore's products are sold through large-volume distributors and building materials retailers.

For the year ended December 31, 2005, Encore reported net income of \$50,079,000 (\$2.13 per share) on net sales of \$758,089,000, compared with net income of \$33,360,000 (\$1.42 per share) on net sales of \$603,225,000 in the previous year. The March 31, 2006 closing market price of Encore's common stock was \$33.88 per share.

At March 31, 2006, 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 \$81,735,000 (\$20.00 per share), representing a fully-diluted equity interest of 17.1%.

Alamo Group Inc. \$45,141,000

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 equipment and replacement parts. Founded in 1969, Alamo Group operates 14 manufacturing facilities and serves governmental, industrial and agricultural markets in North America, Europe, and Australia.

For the year ended December 31, 2005, Alamo reported consolidated earnings of \$11,291,000 (\$1.14 per share) on net sales of \$368,110,000, compared with earnings of \$13,396,000 (\$1.36 per share) on net sales of \$342,171,000 in the previous year. The March 31, 2006 closing NYSE market price of Alamo's common stock was \$22.14 per share.

At March 31, 2006, the \$2,065,047 investment in Alamo by Capital Southwest and its subsidiary was valued at \$45,141,000 (\$16.00 per share), consisting of

2,821,300 restricted shares of common stock, representing a fully-diluted equity interest of 26.2%.

Lifemark Group \$42,000,000

Lifemark Group (formerly Skylawn Corporation), Hayward, California, owns and operates cemeteries, mausoleums and mortuaries. Lifemark's operations, all of which are in California, include a major cemetery 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 and is building a major funeral home on the grounds of its San Mateo County cemetery. 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, 2006, Lifemark reported earnings of \$2,457,000 on revenues of \$27,178,000, compared with earnings of \$2,153,000 on revenues of \$24,964,000 in the previous year.

At March 31, 2006, Capital Southwest owned 100% of Lifemark Group's common stock, which had a cost of \$4,510,400 and was valued at \$42,000,000.

Media Recovery, Inc. \$42,000,000

Media Recovery, Inc., Graham, Texas, distributes computer and office automation supplies and accessories to corporate customers through its direct sales force. Its Shockwatch division manufactures impact and tilt 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, 2005, Media Recovery reported net income of \$5,028,000 on net sales of \$142,574,000, compared with net income of \$3,943,000 on net sales of \$123,664,000 in the previous year.

At March 31, 2006, the \$5,415,000 investment in Media Recovery by Capital Southwest and its subsidiary was valued at \$42,000,000, consisting of 4,800,000 shares of Series A convertible preferred stock, representing a fully-diluted equity interest of 87.4%.

Heeling, Inc. \$30,000,000

Heeling, Inc., Carrollton, Texas, manufactures and markets specialty stealth skate footwear incorporating a patented "wheel in the heel" design under the brand name Heelys. The company manufactures its products in Korea and China and distributes them through domestic and international sporting goods chains, department and lifestyle stores, specialty footwear retailers and on-line at Heelys.com.

During the year ended December 31, 2005, Heeling reported net income of \$4,347,000 on net sales of \$43,950,000, compared with net income of \$803,000 on net sales of \$21,309,000 in the previous year.

At March 31, 2006, the \$120,000 investment in Heeling by Capital Southwest's subsidiary was valued at \$30,000,000 consisting of 436,364 shares of Series B convertible preferred stock, convertible into 436,364 shares of common stock at \$0.275 per share, representing a 43.0% fully-diluted equity interest.

The Whitmore Manufacturing Company \$22,000,000

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 subsidiary, Fluid Protection Corporation, manufactures fluid contamination control devices. The company's assets also include several commercial real estate tracts.

During the year ended March 31, 2006, Whitmore reported net income of \$1,776,000 on net sales of \$18,010,000, compared with net income of \$1,475,000 on net sales of \$16,469,000 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 9).

At March 31, 2006, the direct investment in Whitmore by Capital Southwest was valued at \$22,000,000 and had a cost of \$1,600,000.

Hologic, Inc. \$17,513,294

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 24, 2005, Hologic reported net income of \$28,256,000 (\$0.63 per share) on net sales of \$287,684,000, compared with net income of \$12,164,000 (\$0.29 per share) on net sales of \$228,705,000 in the previous year. The March 31, 2006 closing Nasdaq bid price of Hologic's common stock was \$55.35 per share.

At March 31, 2006, Capital Southwest and its subsidiary owned 316,410 unrestricted shares of common stock, having a cost of \$220,000 and a market value of \$17,513,294 (\$55.35 per share).

Texas Capital Bancshares, Inc. \$11,697,882

Texas Capital Bancshares, Inc. of Dallas, Texas, formed in 1998, has total assets of approximately \$3.0 billion. With banks in Austin, Dallas, Fort Worth, Houston, Plano and San Antonio, Texas Capital Bancshares conducts its business through its wholly-owned subsidiary, Texas Capital Bank, N.A., which targets middle market commercial and wealthy private client customers in Texas.

For the year ended December 31, 2005, Texas Capital reported net income of \$27,192,000 (\$1.02 per share), compared with net income of \$19,560,000 (\$0.75 per share) in the previous year. The March 31, 2006 closing Nasdaq bid price of Texas Capital's common stock was \$23.89 per share.

At March 31, 2006, Capital Southwest owned 489,656 unrestricted shares of common stock, having a cost of \$3,550,006 and a market value of \$11,697,882 (\$23.89 per share).

PETsMART, Inc. \$8,439,000

PETsMART, Inc., Phoenix, Arizona, is the largest specialty retailer of services and solutions for the lifetime needs of pets. The company operates more than 825 pet superstores in the United States and Canada, many of which offer pet grooming services and operate PETsHOTELS. It is also a direct marketer of pet products through its e-commerce site and its pet and equine catalog businesses.

For the year ended January 29, 2006, PETsMART, Inc. reported net income of \$182,490,000 (\$1.25 per share) on net sales of \$3.760 billion, compared with net income of \$157,453,000 (\$1.05 per share) on net sales of \$3.363 billion in the previous year. The March 31, 2006 closing Nasdaq bid price of PETsMART's common stock was \$28.13 per share.

At March 31, 2006, Capital Southwest and its subsidiary owned 300,000 unrestricted shares of common stock, having a cost of \$1,318,771 and a market value of \$8,439,000 (\$28.13 per share).

Cenveo, Inc. \$8,290,000

Cenveo, Inc., Englewood, Colorado, is one of North America's largest providers of visual communication solutions delivered through print and electronic media. Its products include offset and digital printing, custom and stock envelopes, and business documents.

For the year ended December 31, 2005, Cenveo reported a net loss of \$135,052,000 (\$2.70 per share) on net sales of \$1.749 billion, compared with a net loss of \$19,708,000 (\$0.41 per share) on net sales of \$1.743 billion in the previous year. The March 31, 2006 closing NYSE market price of Cenveo's common stock was \$16.58 per share.

At March 31, 2006, Capital Southwest owned 500,000 unrestricted shares of common stock, having a cost of \$712,317 and a market value of \$8,290,000 (\$16.58 per share).

Portfolio of Investments - March 31, 2006

Company	Equity (a)	Investment (b)	Cost	Value (c)
+AT&T, INC. New York, New York Global leader in local, long distance, Internet and transaction- based voice and data services.	<1%	++20,770 shares common stock (acquired 3-9-99)	\$ 12	\$ 561,621
+ALAMO GROUP INC. Seguin, Texas Tractor-mounted mowing and mobile excavation equipment for governmental, industrial and agricultural markets; street-sweeping equipment for municipalities.	26.2%	2,821,300 shares common stock (acquired 4-1-73 thru 10-4-99)	2,065,047	45,141,000
ALL COMPONENTS, INC. Addison, Texas Electronics contract manufacturing; distribution and production of memory and other components for computer manufacturers, retailers and value-added resellers; distribution of automotive accessories.	56.9%	10% subordinated note due 2008 (acquired 10-28-03 thru 10-3-05) 150,000 shares Series A convertible preferred stock, convertible into 600,000 shares of common stock at \$0.25 per share (acquired 9-16-94)	3,000,000 150,000 ----- 3,150,000	3,000,000 2,000,000 ----- 5,000,000
+ALLTEL CORPORATION Little Rock, Arkansas Wireless and wireline local, long-distance, network access and Internet services.	<1%	++8,880 shares common stock (acquired 7-1-98)	108,355	574,980
BALCO, INC. Wichita, Kansas Specialty architectural products used in the construction and remodeling of commercial and institutional buildings	88.5%	445,000 shares common stock and 60,920 shares Class B non-voting common stock (acquired 10-25-83 and 5-30-02)	624,920	2,500,000
BOXX TECHNOLOGIES, INC. Austin, Texas Workstations for computer graphics imaging and design.	15.2%	3,125,354 shares Series B convertible preferred stock, convertible into 3,125,354 shares of common stock at \$0.50 per share (acquired 8-20-99 thru 8-8-01)	1,500,000	2
CMI HOLDING COMPANY, INC. Richardson, Texas Owns Chase Medical, which develops and sells devices used in cardiac surgery to relieve congestive heart failure; develops and supports cardiac imaging systems.	18.5%	10% convertible subordinated notes, convertible into 568,182 shares of common stock at \$1.32 per share, due 2007 (acquired 4-16-04 thru 12-17-04) 2,327,658 shares Series A convertible preferred stock, convertible into 2,327,658 shares of common stock at \$1.72 per share (acquired 8-21-02 and 6-4-03) Warrants to purchase 109,012 shares of common stock at \$1.72 per share, expiring 2012 (acquired 4-16-04)	750,000 4,000,000 -- ----- 4,750,000	750,000 2,000,000 -- ----- 2,750,000
+Publicly-owned company		++Unrestricted securities as defined in Note (b)		

Company	Equity (a)	Investment (b)	Cost	Value (c)
+CENVEO, INC. Englewood, Colorado Envelopes and commercial printing.	<1%	++500,000 shares common stock (acquired 2-18-94 thru 11-10-98)	\$ 712,317	\$ 8,290,000
+COMCAST CORPORATION Philadelphia, Pennsylvania Leading provider of cable, entertainment and communications products and services.	<1%	++43,104 shares common stock (acquired 11-18-02)	21	1,127,601
DENNIS TOOL COMPANY Houston, Texas Polycrystalline diamond compacts (PDCs) used in oil field drill bits and in mining and industrial applications.	67.4%	20,725 shares 5% convertible preferred stock, convertible into 20,725 shares of common stock at \$48.25 per share (acquired 8-10-98) 140,137 shares common stock (acquired 3-7-94 and 8-10-98)	999,981 2,329,963 3,329,944	999,981 2 999,983
+DISCOVERY HOLDING COMPANY Englewood, Colorado Provider of creative content, media management and network services worldwide.	<1%	++70,501 shares Series A common stock (acquired 7-21-05)	20,262	1,056,810
+ENCORE WIRE CORPORATION McKinney, Texas Electric wire and cable for residential and commercial use.	17.1%	4,086,750 shares common stock (acquired 7-16-92 thru 10-7-98)	5,800,000	81,735,000
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.	53.3%	12% subordinated note due 2008, \$1,413,247 principal amount (acquired 9-30-03) 39,359.18 shares Series C convertible preferred stock, convertible into 157,436.72 shares of common stock at \$25.00 per share (acquired 9-30-03) 3,750 shares 8% Series A convertible preferred stock, convertible into 15,000 shares of common stock at \$25.00 per share (acquired 9-30-03) Warrants to purchase 13,035 shares of common stock at \$25.00 per share, expiring 2008 (acquired 8-11-98 thru 9-30-03)	782,481 2,625,000 375,000 -- 3,782,481	1,413,247 3,935,918 375,000 -- 5,724,165
+FMC CORPORATION Chicago, Illinois Chemicals for agricultural, industrial and consumer markets.	<1%	++6,430 shares common stock (acquired 6-6-86)	66,726	398,531
+FMC TECHNOLOGIES, INC. Chicago, Illinois Equipment and systems for the energy, food processing and air transportation industries.	<1%	++11,057 shares common stock (acquired 1-2-02)	57,051	566,340
+Publicly-owned company		++Unrestricted securities as defined in Note (b)		

Company	Equity (a)	Investment (b)	Cost	Value (c)
HEELING, INC. Carrollton, Texas Heelys stealth skate shoes sold through sporting goods chains, department stores, footwear retailers and on-line at Heelys.com.	43.0%	436,364 shares Series B convertible preferred stock, convertible into 436,364 shares of common stock at \$0.275 per share (acquired 5-26-00)	\$ 120,000	\$ 30,000,000
HIC-STAR CORPORATION (formerly AmPro Mortgage Corporation) Dallas, Texas Holding company previously engaged in mortgage banking operations, which have now been sold.	34.9%	10% subordinated note due 2007 (acquired 10-19-04 and 1-13-05) 12% subordinated notes due 2008 (acquired 3-25-05 thru 2-27-06) 5,000 shares Series A cumulative preferred stock (acquired 2-28-03) 1,500 shares Series B cumulative preferred stock (acquired 3-31-04) 29,167 shares Series A common stock (acquired 2-28-03) Warrants to purchase 463,162 shares of Series A common stock at \$1.00 per share, expiring 2014 (acquired 3-31-04 thru 1-13-05)	352,646 819,978 5,000,000 1,500,000 29,167 --	352,646 819,978 -- -- -- --
			7,701,791	1,172,624
+HOLOGIC, INC. Bedford, Massachusetts Medical instruments including bone densitometers, mammography devices and digital radiography systems.	<1%	++316,410 shares common stock (acquired 8-27-99)	220,000	17,513,294
+KIMBERLY-CLARK CORPORATION Dallas, Texas Manufacturer of tissue, personal care and health care products.	<1%	++77,180 shares common stock (acquired 12-18-97)	2,358,518	4,461,004
+LIBERTY GLOBAL, INC. Englewood, Colorado Owns interests in broadband, distribution and content companies.	<1%	++42,463 shares Series A common stock (acquired 6-15-05) ++42,463 shares Series C common stock (acquired 9-6-05)	106,553 100,870	867,094 835,672
			207,423	1,702,766
+LIBERTY MEDIA CORPORATION Englewood, Colorado Holding company owning interests in electronic retailing, media, communications and entertainment businesses.	<1%	++705,010 shares Series A common stock (acquired 3-9-99 thru 12-12-02)	118,253	5,788,132
LIFEMARK GROUP (formerly Skylawn Corporation) Hayward, California Cemeteries, mausoleums and mortuaries located in northern California.	100.0%	1,449,026 shares common stock (acquired 7-16-69)	4,510,400	42,000,000
+Publicly-owned company		++Unrestricted securities as defined in Note (b)		

Company	Equity (a)	Investment (b)	Cost	Value (c)
MEDIA RECOVERY, INC. Graham, Texas Computer and office automation supplies and accessories; impact and tilt monitoring devices to detect mishandled shipments; dunnage for protecting shipments.	87.4%	4,800,000 shares Series A convertible preferred stock, convertible into 4,800,000 shares of common stock at \$1.00 per share (acquired 11-4-97)	\$ 5,415,000	\$ 42,000,000
PALLETONE, INC. Bartow, Florida Wood pallet manufacturer with 14 manufacturing facilities.	9.7%	1,796,850 shares Series A preferred stock (acquired 10-18-01) 150,000 shares common stock (acquired 10-18-01) Warrant to purchase 15,294 shares of common stock at \$1.00 per share, expiring 2011 (acquired 2-17-06)	1,350,000 150,000 45,746	1,796,850 730,000 59,000
			1,545,746	2,585,850
+PALM HARBOR HOMES, INC. Dallas, Texas Integrated manufacturing, retailing, financing and insuring of manufactured housing and modular homes.	30.5%	7,855,121 shares common stock (acquired 1-3-85 thru 7-31-95)	10,931,955	98,189,000
+PETSMART, INC. Phoenix, Arizona Retail chain of more than 825 stores selling pet foods, supplies and services.	<1%	++300,000 shares common stock (acquired 6-1-95)	1,318,771	8,439,000
PHARMAFAB, INC. Grand Prairie, Texas Contract manufacturer of branded and generic pharmaceutical drugs; developer of drug delivery technology.	67.5%	6% convertible subordinated notes, \$4,205,616 principal amount, convertible into Series A or B convertible preferred stock, convertible into 560,750 shares of common stock at \$7.50 per share, due 2013 (acquired 2-28-06) 54,000 shares Series A convertible preferred stock, convertible into 720,000 shares of common stock at \$7.50 per share (acquired 8-1-03 and 2-24-06) 1,000 shares Series B convertible preferred stock, convertible into 13,334 shares of common stock at \$7.50 per share (acquired 8-1-03) Warrants to purchase 16,668 shares of Series A or B convertible preferred stock at \$100.00 per share, convertible into 111,120 shares of common stock at \$7.50 per share, expiring 2012 and 2013 (acquired 6-16-05 and 2-28-06)	4,000,000 5,400,000 100,000 --	4,000,000 -- -- --
			9,500,000	4,000,000
THE RECTORSEAL CORPORATION Houston, Texas Specialty chemicals for plumbing, HVAC, electrical, construction, industrial, oil field and automotive applications; smoke containment systems for building fires; owns 20% of Whitmore Manufacturing Company.	100.0%	27,907 shares common stock (acquired 1-5-73 and 3-31-73)	52,600	87,500,000
+Publicly-owned company		++Unrestricted securities as defined in Note (b)		

Company	Equity (a)	Investment (b)	Cost	Value (c)
+SPRINT NEXTEL CORPORATION Westwood, Kansas Diversified telecommunications company.	<1%	++90,000 shares common stock (acquired 6-20-84)	\$ 503,645	\$ 2,325,600
TCI HOLDINGS, INC. Denver, Colorado Cable television systems and microwave	-	21 shares 12% Series C cumulative compounding preferred stock (acquired 1-30-90)	--	677,250
+TEXAS CAPITAL BANCSHARES, INC. Dallas, Texas Regional bank holding company with banking operations in six Texas cities.	1.6%	++489,656 shares common stock (acquired 5-1-00)	3,550,006	11,697,882
VIA HOLDINGS, INC. Sparks, Nevada Designer, manufacturer and distributor of high-quality office seating.	28.8%	9,118 shares Series B preferred stock (acquired 9-19-05)	4,559,000	4,559,000
WELLOGIX, INC. Houston, Texas Developer and supporter of software used by the oil and gas industry to control drilling and maintenance expenses.	19.6%	4,231,861 shares Series A-1 convertible participating preferred stock, convertible into 4,231,861 shares of common stock at \$1.1815 per share (acquired 8-19-05)	5,000,000	5,000,000
THE WHITMORE MANUFACTURING COMPANY Rockwall, Texas Specialized mining, industrial and railroad lubricants; coatings for automobiles and primary metals; fluid contamination control devices.	80.0%	80 shares common stock (acquired 8-31-79)	1,600,000	22,000,000
MISCELLANEOUS	-	Diamond State Ventures, L.P. - 1.9% limited partnership interest (acquired 10-12-99 thru 8-26-05)	210,000	210,000
	-	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)	--	152,000
	-	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)	1,000,000	1
	-	Sterling Group Partners I, L.P. - 1.7% limited partnership interest (acquired 4-20-01 thru 1-24-05)	1,064,042	1,064,042
TOTAL INVESTMENTS			\$88,596,956 =====	\$550,428,083 =====
+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 shares, plus shares 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 one percent.

(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, 2006, restricted securities represented approximately 88.3% 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 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 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.

(d) Agreements between certain issuers and the Company provide that the issuers will bear substantially all costs in connection with the disposition of common stocks, including those costs involved in registration under the Securities Act of 1933 but excluding underwriting discounts and commissions. These agreements cover common stocks owned at March 31, 2006 and common stocks which may be acquired thereafter through exercise of warrants and conversion of debentures and preferred stocks. 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 independent auditors. 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
All Components, Inc.	\$ 500,000
Diamond State Ventures, L.P.	19,375
First Capital Group of Texas III, L.P.	200,000
Hic-Star Corporation (formerly AmPro Mortgage Corporation)	723,923
PalletOne, Inc.	45,746
PharmaFab, Inc.	4,000,000
VIA Holdings, Inc.	4,559,000
Wellogix, Inc.	5,000,000
Miscellaneous	6,697
	\$15,054,741

Dispositions

	Cost	Amount Received
Cenveo, Inc.	\$ 2,274,553	\$15,833,234
Exopack Holding Corp.	623,790	2,054,880
Heeling, Inc.	480,000	480,000
Organized Living, Inc.	6,000,000	--
Sterling Group Partners I, L.P.....	284,366	1,241,751
Tekelec	54,580	73,533
Texas Capital Bancshares, Inc.....	725,000	2,327,408
Texas Shredder, Inc.	75,000	8,783,891
Miscellaneous	6,697	7,855
	\$10,523,986	\$30,802,552

Repayments Received		\$ 480,197
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Capital Southwest Corporation and Subsidiaries
Consolidated Statements of Financial Condition

Assets	March 31	
	2006	2005
Investments at market or fair value		
Companies more than 25% owned		
(Cost: 2006 - \$23,114,866,		
2005 - \$23,114,866)	\$298,481,983	\$259,628,981
Companies 5% to 25% owned		
(Cost: 2006 - \$18,595,746,		
2005 - \$19,050,000)	92,070,852	44,890,852
Companies less than 5% owned		
(Cost: 2006 - \$46,886,344,		
2005 - \$42,381,532)	159,875,248	117,502,389
Total investments		
(Cost: 2006 - \$88,596,956,		
2005 - \$84,546,398)	550,428,083	422,022,222
Cash and cash equivalents	11,503,866	5,104,935
Receivables	135,887	136,401
Other assets	7,300,297	7,120,043
Totals	\$569,368,133	\$434,383,601
	=====	=====

Liabilities and Shareholders' Equity	March 31	
	2006	2005
Note payable to bank	\$ 8,000,000	\$ 8,000,000
Note payable to portfolio company	--	5,000,000
Accrued interest and other liabilities	1,697,086	1,842,587
Income taxes payable	982,653	--
Deferred income taxes	162,070,285	117,007,107
Total liabilities	172,750,024	131,849,694
Shareholders' equity		
Common stock, \$1 par value: authorized,		
5,000,000 shares; issued, 4,297,616		
shares at March 31, 2006 and 4,294,416		
shares at March 31, 2005	4,297,616	4,294,416
Additional capital	8,109,797	7,904,997
Undistributed net investment		
income	3,744,830	3,669,805
Undistributed net realized gain on		
investments	86,432,040	73,316,166
Unrealized appreciation of investments -		
net of deferred income taxes	301,067,128	220,381,825
Treasury stock - at cost		
(437,365 shares)	(7,033,302)	(7,033,302)
Net assets at market or fair value, equivalent		
to \$102.74 per share at March 31, 2006 on		
the 3,860,251 shares outstanding and		
\$78.44 per share at March 31, 2005 on the		
3,857,051 shares outstanding	396,618,109	302,533,907
Totals	\$ 569,368,133	\$ 434,383,601
	=====	=====

See Notes to Consolidated Financial Statements

Capital Southwest Corporation and Subsidiaries
Consolidated Statements of Operations

	Years Ended March 31		
	2006	2005	2004
Investment income:			
Interest	\$ 505,536	\$ 437,753	\$ 213,987
Dividends	3,485,430	3,778,190	3,860,937
Management and directors' fees	848,070	637,000	632,864
	4,839,036	4,852,943	4,707,788
Operating expenses:			
Salaries	1,211,584	1,132,510	997,079
Net pension benefit	(116,747)	(254,872)	(272,912)
Other operating expenses	859,702	1,068,313	775,847
	1,954,539	1,945,951	1,500,014
Income before interest expense and income taxes	2,884,497	2,906,992	3,207,774
Interest expense	436,021	420,351	531,068
Income before income taxes	2,448,476	2,486,641	2,676,706
Income tax expense	59,220	80,693	89,646
Net investment income	\$ 2,389,256	\$ 2,405,948	\$ 2,587,060
Proceeds from disposition of investments	\$ 30,802,552	\$ 4,565,232	\$ 16,486,067
Cost of investments sold	10,523,986	14,677,252	3,883,188
Realized gain (loss) on investments before income taxes	20,278,566	(10,112,020)	12,602,879
Income tax expense (benefit)	7,162,692	(4,046,206)	4,411,007
Net realized gain (loss) on investments	13,115,874	(6,065,814)	8,191,872
Increase in unrealized appreciation of investments before income taxes	124,355,303	27,809,654	114,067,574
Increase in deferred income taxes on appreciation of investments	43,670,000	9,925,000	39,379,000
Net increase in unrealized appreciation of investments	80,685,303	17,884,654	74,688,574
Net realized and unrealized gain on investments	\$ 93,801,177	\$ 11,818,840	\$ 82,880,446
Increase in net assets from operations	\$ 96,190,433	\$ 14,224,788	\$ 85,467,506

See Notes to Consolidated Financial Statements

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

	Years Ended March 31		
	2006	2005	2004
Operations			
Net investment income	\$ 2,389,256	\$ 2,405,948	\$ 2,587,060
Net realized gain (loss) on investments	13,115,874	(6,065,814)	8,191,872
Net increase in unrealized appreciation of investments	80,685,303	17,884,654	74,688,574
Increase in net assets from operations	96,190,433	14,224,788	85,467,506
Distributions from:			
Undistributed net investment income	(2,314,231)	(2,314,231)	(2,308,631)
Capital share transactions			
Exercise of employee stock options	208,000	--	997,500
Increase in net assets	94,084,202	11,910,557	84,156,375
Net assets, beginning of year	302,533,907	290,623,350	206,466,975
Net assets, end of year	\$ 396,618,109	\$ 302,533,907	\$ 290,623,350

See Notes to Consolidated Financial Statements

Capital Southwest Corporation and Subsidiaries
Consolidated Statements of Cash Flows

	Years Ended March 31		
	2006	2005	2004
Cash flows from operating activities			
Increase in net assets from operations	\$ 96,190,433	\$ 14,224,788	\$ 85,467,506
Adjustments to reconcile increase in net assets from operations to net cash provided by operating activities:			
Proceeds from disposition of investments	30,802,552	4,510,652	16,486,067
Purchases of securities	(15,054,741)	(2,280,690)	(12,458,840)
Maturities of securities	480,197	394,269	2,754,845
Depreciation and amortization	16,136	17,597	19,089
Net pension benefit	(116,747)	(254,872)	(272,912)
Realized (gain) loss on investments before income taxes	(20,278,566)	10,112,020	(12,602,879)
Deferred taxes on realized (gain) loss on investments	2,335,031	(4,046,206)	4,411,007
Net increase in unrealized appreciation of investments	(80,685,303)	(17,884,654)	(74,688,574)
(Increase) decrease in receivables	514	(59,924)	221,187
(Increase) decrease in other assets	(3,226)	(10,477)	5,023
Increase (decrease) in accrued interest and other liabilities	(67,245)	121,196	41,701
Decrease in accrued pension cost	(154,673)	(164,129)	(167,281)
Deferred income taxes	40,800	88,800	95,600
Net cash provided by operating activities	13,505,162	4,768,370	9,311,539
Cash flows from financing activities			
Decrease in note payable to bank	--	(7,500,000)	--
Decrease in notes payable to portfolio company	(5,000,000)	--	(2,500,000)
Distributions from undistributed net investment income	(2,314,231)	(2,314,231)	(2,308,631)
Proceeds from exercise of employee stock options	208,000	--	997,500
Net cash used in financing activities	(7,106,231)	(9,814,231)	(3,811,131)
Net increase (decrease) in cash and cash equivalents	6,398,931	(5,045,861)	5,500,408
Cash and cash equivalents at beginning of year	5,104,935	10,150,796	4,650,388
Cash and cash equivalents at end of year	\$ 11,503,866	\$ 5,104,935	\$ 10,150,796
Supplemental disclosure of cash flow information:			
Cash paid during the year for: Interest	\$ 436,920	\$ 420,446	\$ 531,194
Income taxes	\$ 4,846,081	\$ --	\$ --

See Notes to 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.

Stock-Based Compensation. Effective April 1, 2003, the Company adopted the fair value method of recording compensation expense related to all stock options granted after March 31, 2003, in accordance with Financial Accounting Standards ("FASB") Statement Nos. 123 and 148. Accordingly, the fair value of stock options as determined on the date of grant using the Black-Scholes pricing model will be expensed over the vesting period of the related stock options. On July 19, 2004, 7,500 stock options were granted to a new investment associate who resigned on December 31, 2004 with no options vested.

The following table illustrates the effect on net asset value and net asset value per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123 to stock-based compensation for options granted prior to the implementation of FASB Statement No. 123.

	Years Ended March 31		
	2006	2005	2004
Net asset value, as reported	\$396,618,109	\$302,533,907	\$290,623,350
Deduct: Total fair value computed stock-based compensation	150,936	160,764	179,440
Pro forma net asset value	\$396,467,173	\$302,373,143	\$290,443,910
Net asset value per share:			
Basic - as reported	\$102.74	\$78.44	\$75.35
Basic - pro forma	\$102.71	\$78.39	\$75.30
Diluted - as reported	\$102.49	\$78.38	\$75.32
Diluted- pro forma	\$102.45	\$78.34	\$75.27

The diluted net asset value per share calculation assumes all vested outstanding options for which the market price exceeds the exercise price have been exercised.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment ("SFAS 123R"), which revises 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 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.

SFAS 123R provides for adoption using either the modified prospective or modified retrospective transition method. The Company will adopt SFAS 123R on April 1, 2006 using the modified prospective transition method in which compensation cost is recognized beginning April 1, 2006 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 Company will continue to use the Black-Scholes pricing model to determine the fair value of stock option awards.

The future impact of SFAS 123R on results of operations cannot be predicted at this time because it will depend on levels of share-based payments granted. However, had SFAS 123R been adopted in prior periods, the effect would have approximated the SFAS 123 pro forma net asset value and net asset value per share disclosures as shown above.

SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as currently required, thereby reducing net operating cash flows and increasing net financing cash flows in periods after adoption. Those amounts cannot be estimated for future periods (because they depend on, among other things, when employees will exercise the stock options and the market price of the Company's common stock at the time of exercise).

2. Valuation of Investments

The consolidated financial statements as of March 31, 2006 and 2005 include securities valued at \$485,924,522 (88.3% of the value of the consolidated investment portfolio) and \$364,732,932 (86.4% 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.

3. Income Taxes

For the tax years ended December 31, 2005, 2004 and 2003, CSC and CSVC qualified to be taxed as regulated investment companies ("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). Both CSC and CSVC intend to meet the applicable qualifications to be taxed as RICs in future years; however, either company's ability to meet certain portfolio diversification requirements of RICs in future years may not be controllable by such company.

For the year ended December 31, 2005, CSC and CSVC had net investment income for book and tax purposes of \$2,314,231 and \$574,794, respectively, all of which has been distributed. During 2005, CSC and CSVC had a net capital gain for book purposes of \$12,625,800 and \$6,958,957, respectively, and a net capital gain for tax purposes of \$16,783,112 and \$6,958,957, respectively.

The aggregate cost of investments for federal income tax purposes as of March 31, 2006 was \$91,104,094. Such investments had unrealized appreciation of \$480,868,317 and unrealized depreciation of \$19,037,190 for book purposes, or net unrealized appreciation of \$461,831,127. They had unrealized appreciation of \$478,614,873 and unrealized depreciation of \$19,290,884 for tax purposes, or net unrealized appreciation of \$459,323,989 at March 31, 2006. The difference between book basis and tax basis net unrealized appreciation is attributable primarily to interest income that was accrued for tax purposes, but not for book purposes.

CSC and CSVC may not qualify or elect to be taxed as RICs in future years. Therefore, consolidated deferred Federal income taxes of \$160,764,000 and \$117,094,000 have been provided on net unrealized appreciation of investments of \$461,831,127 and \$337,475,824 at March 31, 2006 and 2005, respectively. Such appreciation is not included in taxable income until realized. Deferred income taxes on net unrealized appreciation of investments have been provided at the then currently effective maximum Federal corporate tax rate on capital gains of 35% at March 31, 2006 and 2005.

4. Notes Payable

The note payable to bank at March 31, 2006 and 2005 was from an unsecured revolving line of credit of \$25,000,000 of which \$8,000,000 had been drawn at March 31, 2006 and 2005. The revolving line of credit bears interest at the bank's base rate less .50% or LIBOR plus 1.25% and matures on August 31, 2007.

The note payable to portfolio company was a demand promissory note to Lifemark Group (formerly Skylawn Corporation) with interest payable at the greater of prime minus 2.0% or the Applicable Federal Rate established by the Internal Revenue Service. Interest expense on this portfolio company note was \$32,329 in 2006 and \$134,542 in 2005.

5. Employee Stock Option Plan

Under the 1984 Incentive Stock Option Plan, 28,000 options were exercised in 2004. The 1984 Incentive Stock Option Plan expired in 1994.

On July 19, 1999, shareholders approved the 1999 Stock Option Plan ("Plan"), which provides for the granting of stock options to employees and officers of the Company and authorizes the issuance of common stock upon the exercise of such options for up to 140,000 shares of common stock. All options are granted at or above market price and generally expire ten years from the date of grant and are generally exercisable on or after the first anniversary of the date of grant in five to ten annual installments.

At March 31, 2006, there were 91,500 shares available for grant under the Plan. The per share weighted-average fair value of stock options granted during 2005 was \$23.53 on the date of grant using the Black Scholes option-pricing model with the following assumptions: expected dividend yield of .79%, risk-free interest rate of 4.07%, expected volatility of 22.6%, and expected life of 7 years.

The following summarizes activity in the stock option plans for the years ended March 31, 2006, 2005 and 2004:

	Number of shares	Weighted Average Exercise Price
	-----	-----
Balance at April 1, 2003	82,500	\$58.336
Granted	--	--
Exercised	(28,000)	35.625
Canceled	--	--
	-----	-----
Balance at March 31, 2004	54,500	70.004
Granted	7,500	76.000
Exercised	--	--
Canceled	(13,500)	79.870
	-----	-----
Balance at March 31, 2005	48,500	68.186
Granted	--	--
Exercised	(3,200)	65.000
Canceled	--	--
	-----	-----
Balance at March 31, 2006	45,300	\$68.411
	=====	=====

At March 31, 2006, the range of exercise prices and weighted-average remaining contractual life of outstanding options was \$65.00 - \$77.00 and 4.81 years, respectively.

At March 31, 2006, 2005 and 2004, the number of options exercisable was 29,500, 25,650 and 24,200, respectively and the weighted-average exercise price of those options was \$69.01, \$68.98 and \$73.24, 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. During the three years ended March 31, 2006, the Company made contributions to the ESOP, which were charged against net investment income, of \$99,167 in 2006, \$93,588 in 2005 and \$88,937 in 2004.

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 ten 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, 2006.

The following tables set forth the qualified plan's benefit obligations and fair value of plan assets at March 31, 2006, 2005 and 2004:

	Years Ended March 31		
	2006	2005	2004
Change in benefit obligation			
Benefit obligation at beginning of year	\$ 3,833,411	\$ 3,799,113	\$ 3,676,599
Service cost	95,590	92,434	81,309
Interest cost	223,374	214,076	215,511
Actuarial loss	228,122	94,812	189,566
Benefits paid	(376,480)	(367,024)	(363,872)
Benefit obligation at end of year	\$ 4,004,017	\$ 3,833,411	\$ 3,799,113
Change in plan assets			
Fair value of plan assets at beginning of year	\$ 9,326,254	\$ 10,030,763	\$ 6,881,723
Actual return on plan assets	2,690,919	(337,485)	3,512,912
Benefits paid	(376,480)	(367,024)	(363,872)
Fair value of plan assets at end of year	\$ 11,640,693	\$ 9,326,254	\$ 10,030,763

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	
	2006	2005
Actuarial present value of benefit obligations:		
Accumulated benefit obligation	\$(3,475,899)	\$(3,392,308)
Projected benefit obligation for service rendered to date	\$(4,004,017)	\$(3,833,411)
Plan assets at fair value*	11,640,693	9,326,254
Excess of plan assets over the projected benefit obligation	7,636,676	5,492,843
Unrecognized net (gain) loss from past experience different from that assumed and effects of changes in assumptions	(670,478)	1,272,655
Unrecognized prior service costs	195,281	202,816
Prepaid pension cost included in other assets	\$ 7,161,479	\$ 6,968,314

*Primarily equities and bonds including approximately 28,000 shares of common stock of the Company.

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

	Years Ended March 31		
	2006	2005	2004
Service cost - benefits earned during the year	\$ 95,590	\$ 92,434	\$ 81,309
Interest cost on projected benefit obligation	223,374	214,076	215,511
Expected return on assets	(551,026)	(564,627)	(576,020)
Net amortization and deferral	38,897	(66,280)	(66,296)
Net pension benefit from qualified plan	=====	=====	=====

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, 2006, 2005 and 2004:

	Years Ended March 31		
	2006	2005	2004
Change in benefit obligation			
Benefit obligation at beginning of year	\$1,302,368	\$1,414,091	\$1,353,386
Service cost	19,094	10,380	5,464
Interest cost	72,886	74,711	82,683
Actuarial (gain) loss	40,867	(32,685)	139,839
Benefits paid	(154,673)	(164,129)	(167,281)
Benefit obligation at end of year	=====	=====	=====

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	
	2006	2005
Projected benefit obligation	\$(1,280,542)	\$(1,302,368)
Unrecognized net loss from past experience different from that assumed and effects of changes in assumptions.....	93,049	52,182
Unrecognized prior service costs	(239,573)	(255,136)
Accrued pension cost included in other liabilities	=====	=====

The Retirement Restoration Plan expenses recognized during the years ended March 31, 2006, 2005 and 2004 of \$76,417, \$69,528 and \$72,584, 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		
	2006	2005	2004
Discount rate	5.75%	5.75%	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		
	2006	2005	2004

Discount rate.....	-----	-----	-----
	5.75%	5.75%	6.0%
Expected return on plan assets.....	6.0%	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:

Asset Category	Percentage of plan assets at March 31	
	2006	2005
Equity securities.....	83.6%	78.6%
Debt securities.....	12.9%	16.2%
Cash	3.5%	5.2%
	100.0%	100.0%
	=====	=====

The Company's pension plan is administered by a board-appointed committee that has fiduciary responsibility for the plan's management. The trustee of the plan is JPMorgan Asset Management. Currently approximately 20% 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 2012-2016:

(In Thousands)	Years Ended March 31					2012-
	2007	2008	2009	2010	2011	2016
	\$ 352	\$ 334	\$ 316	\$ 296	\$ 276	\$1,132

8. Commitments

The Company has agreed, subject to certain conditions, to invest up to \$1,191,154 in three portfolio companies.

The Company leases office space under an operating lease which requires base annual rentals of approximately \$80,000 through February, 2008. For the three years ended March 31, total rental expense charged to investment income was \$76,877 in 2006, \$75,248 in 2005 and \$74,122 in 2004.

9. Sources of Income

Income was derived from the following sources:

Years Ended March 31	Investment Income			Realized Gain (Loss) on Investments Before Income Taxes
	Interest	Dividends	Other Income	
2006				
Companies more than 25% owned	\$ --	\$2,926,964	\$642,500	\$ --
Companies 5% to 25% owned	(55,236)	188,233	10,000	--
Companies less than 5% owned	302,622	370,233	195,570	20,278,566
Other sources, including temporary investments	258,150	--	--	--
	\$505,536	\$3,485,430	\$848,070	\$ 20,278,566
2005				
Companies more than 25% owned	\$ --	\$3,361,345	\$637,000	\$ --
Companies 5% to 25% owned	55,236	80,858	--	(12,097,124)
Companies less than 5% owned	346,396	335,987	--	1,985,104
Other sources,				

including temporary
investments

36,121	--	--	--

\$437,753	\$3,778,190	\$637,000	\$ (10,112,020)
=====			

Years Ended March 31 ----- 2004 -----	Investment Income			Realized Gain (Loss) on Investments Before Income Taxes -----
	Interest	Dividends	Other Income	
Companies more than 25% owned	\$ --	\$3,577,800	\$629,000	\$ --
Companies 5% to 25 owned	--	--	3,864	(188,900)
Companies less than 5% owned	203,304	283,137	--	12,791,779
Other sources, including temporary investments	10,683	--	--	--
	-----	-----	-----	-----
	\$213,987	\$3,860,937	\$632,864	\$ 12,602,879
	=====	=====	=====	=====

Selected Per Share Data and Ratios

Per Share Data	Years Ended March				
	2006	2005	2004	2003	2002
Investment income	\$ 1.25	\$ 1.26	\$ 1.22	\$ 1.06	\$ 1.08
Operating expenses	(.51)	(.51)	(.39)	(.30)	(.27)
Interest expense	(.11)	(.11)	(.14)	(.12)	(.24)
Income taxes	(.01)	(.02)	(.02)	(.04)	(.04)
Net investment income .....	.62	.62	.67	.60	.53
Distributions from undistributed net investment income	(.60)	(.60)	(.60)	(.60)	(.60)
Net realized gain (loss) on investments	3.40	(1.57)	2.13	.35	(.14)
Net increase (decrease) in unrealized appreciation of investments after deferred taxes	20.90	4.64	19.37	(11.85)	6.31
Exercise of employee stock options*	(.02)	--	(.14)	--	(.08)
Increase (decrease) in net asset value	24.30	3.09	21.43	(11.50)	6.02
Net asset value					
Beginning of year	78.44	75.35	53.92	65.42	59.40
End of year	\$ 102.74	\$ 78.44	\$ 75.35	\$ 53.92	\$ 65.42
Increase (decrease) in deferred taxes on unrealized appreciation					
Deferred taxes on unrealized appreciation:					
Beginning of year	30.36	27.79	17.70	24.05	20.79
End of year	\$ 41.65	\$ 30.36	\$ 27.79	\$ 17.70	\$ 24.05
Ratios and Supplemental Data					
Ratio of operating expenses to average net assets .....	.58%	.67%	.63%	.52%	.42%
Ratio of operating expenses to average net assets plus average deferred taxes on unrealized appreciation .....	.42%	.49%	.47%	.39%	.31%
Ratio of net investment income to average net assets .....	.71%	.83%	1.09%	1.04%	.85%
Portfolio turnover rate	2.36%	.56%	3.74%	1.53%	1.05%
Net asset value total return	33.69%	4.90%	41.16%	(16.75)%	11.18%
Shares outstanding at end of period (000s omitted)	3,860	3,857	3,857	3,829	3,829

* 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, 2006. 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, 2006, the Company's internal control over financial reporting was effective.

Grant Thornton LLP has issued its attestation report on management's assessment and on the effectiveness of the Company's internal control over financial reporting. That report appears on the next page.

Date: May 24, 2006

/s/ William R. Thomas

*William R. Thomas
President & Chairman of the Board*

/s/ Susan K. Hodgson

*Susan K. Hodgson
Secretary-Treasurer
(chief financial/accounting officer)*

To the Board of Directors and Shareholders of Capital Southwest Corporation

We have audited management's assessment, included in Management's Report on Internal Control Over Financial Reporting, that Capital Southwest Corporation and subsidiaries (the "Company") maintained effective internal control over financial reporting as of March 31, 2006, 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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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, management's assessment that Capital Southwest Corporation and subsidiaries maintained effective internal control over financial reporting as of March 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Capital Southwest Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of March 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of Capital Southwest Corporation and subsidiaries as of March 31, 2006 and 2005, including the portfolio of investments as of March 31, 2006, on pages 12-17, and the related statements of operations, changes in net assets, and cash flows, and the selected per share data and ratios on page 29 for each of the two years in the period ended March 31, 2006, and our report dated May 26, 2006 expressed an unqualified opinion on those financial statements and per share data and ratios.

/s/Grant Thornton LLP

*Dallas, Texas
May 26, 2006*

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Capital Southwest Corporation

We have audited the accompanying consolidated statements of financial condition of Capital Southwest Corporation (a Texas Corporation) and subsidiaries as of March 31, 2006 and 2005, including the portfolio of investments as of March 31, 2006, on pages 12-17, and the related consolidated statements of operations, changes in net assets, and cash flows, and the selected per share data and ratios on page 29, for each of the two years in the period ended March 31, 2006. 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.

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 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, 2006 and 2005, and confirmation of securities not held by the custodian by correspondence with others. 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, 2006 and 2005, and the consolidated results of operations, changes in net assets, and cash flows, and the selected per share data and ratios for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Capital Southwest Corporation and subsidiaries' internal control over financial reporting as of March 31, 2006 and 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our accompanying report dated May 26, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of Capital Southwest Corporation and subsidiaries' internal control over financial reporting.

/S/GRANT THORNTON LLP

*Dallas, Texas
May 26, 2006*

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Capital Southwest Corporation:

We have audited the accompanying consolidated statements of operations, changes in net assets, and cash flows of Capital Southwest Corporation and subsidiaries for the year ended March 31, 2004, and the selected per share data and ratios for the year then ended. 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 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 the financial statements 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, 2004 and confirmation of securities not held by the custodian by correspondence with others. 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements and selected per share data and ratios referred to above present fairly, in all material respects, the consolidated results of operations, and the changes in net assets and cash flows for the year ended March 31, 2004, and the selected per share data and ratios for the year then ended, of Capital Southwest Corporation and subsidiaries in conformity with U.S. generally accepted accounting principles.

ERNST & YOUNG LLP

Dallas, Texas
May 12, 2004

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 or benefit. 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, net of an increase in deferred income taxes which would become payable if the unrealized appreciation were realized through the sale or other disposition of the investment portfolio. 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 \$257,374 in 2006, \$35,048 in 2005 and \$10,247 in 2004. The Company also receives management fees primarily from its wholly-owned portfolio companies which aggregated \$792,570 in 2006 and \$597,000 in 2005 and 2004. During the three years ended March 31, 2006, the Company recorded dividend income from the following sources:

	Years Ended March 31		
	2006	2005	2004
Alamo Group Inc.	\$ 677,112	\$ 677,112	\$ 677,112
Balco, Inc.	252,960	252,960	252,960
Dennis Tool Company	49,999	25,000	49,999
Kimberly-Clark Corporation	142,011	127,347	109,596
Lifemark Group	600,000	600,000	950,000
PalletOne, Inc.	179,685	80,858	--
The RectorSeal Corporation	1,106,893	960,000	1,407,729
Sprint Nextel Corporation	18,000	45,000	36,000
TCI Holdings, Inc.	81,270	81,270	81,270
The Whitmore Manufacturing Company	240,000	846,273	240,000
Other	137,500	82,370	56,271
	-----	-----	-----
	\$3,485,430	\$3,778,190	\$3,860,937
	=====	=====	=====

Total operating expenses, excluding interest expense, increased by \$445,937 or 29.7% during the year ended March 31, 2005. 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 and accounting fees and the net pension benefit. Interest expense decreased by \$110,717 during the year ended March 31, 2005 primarily due to a decrease in notes payable.

Net Realized Gain (Loss) on Investments

Net realized gain on investments was \$13,115,874 (after income tax expense of \$7,162,692) during the year ended March 31, 2006, compared with a loss of \$6,065,814 (after income tax benefit of \$4,046,206) during 2005 and a gain of \$8,191,872 (after income tax expense of \$4,411,007) during 2004. 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 an increase in unrealized appreciation of investments before income taxes of \$124,355,303, \$27,809,654 and \$114,067,574 in 2006, 2005 and 2004, 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 (before the related change in deferred income taxes and 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		
	2006	2005	2004
Alamo Group Inc.	\$ (5,642,000)	\$ 19,749,000	\$ 8,464,000
Encore Wire Corporation ..	49,041,000	(27,245,000)	46,316,000
Heeling, Inc.	27,000,000	1,400,000	1,480,000
Hologic, Inc.	12,472,883	1,836,760	1,833,596
Media Recovery, Inc.	15,744,000	9,256,000	7,000,000
Palm Harbor Homes, Inc. ..	27,493,000	(15,710,000)	15,710,000
The RectorSeal Corporation	15,000,000	12,500,000	5,000,000

As shown in the above table, the three investments achieving the largest increases in value during the year ended March 31, 2006 were Encore Wire Corporation, Palm Harbor Homes, Inc. and Heeling, Inc. The major increase in Encore's value was attributable to significant increases in gross profit margins as copper prices soared to record levels. The increase in Palm Harbor's value reflected the improved condition of the markets for manufactured housing and modular homes. The other major increase in value was experienced by Heeling, Inc. as sales of its Heelys skate shoes doubled in 2005 and its order backlog reached a record high level.

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, 2006."

Deferred Taxes on Unrealized Appreciation of Investments

The Company provides for deferred Federal income taxes on net unrealized appreciation of investments. Such taxes would become payable at such time as unrealized appreciation is realized through the sale or other disposition of those components of the investment portfolio which would result in taxable transactions. At March 31, 2006 consolidated deferred Federal income taxes of \$160,764,000 were provided on net unrealized appreciation of investments of \$461,831,127 compared with deferred taxes of \$117,094,000 on net unrealized appreciation of \$337,475,824 at March 31, 2005. Deferred income taxes at March 31, 2006 and 2005 were provided at the then currently effective maximum Federal corporate tax rate on capital gains of 35%.

Portfolio Investments

During the year ended March 31, 2006, the Company invested \$15,054,741 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 2005 and 2004 fiscal years, the Company invested a total of \$2,280,690 and \$12,458,840, respectively.

Financial Liquidity and Capital Resources

At March 31, 2006, the Company had cash and cash equivalents of approximately \$11.5 million. Pursuant to Small Business Administration ("SBA") regulations, cash and cash equivalents of \$0.3 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 SBA's approval of its credit application, CSVC would be entitled to borrow up to \$72.0 million. The Company also has an unsecured \$25.0 million revolving line of credit from a commercial bank, of which \$17.0 million was available at March 31, 2006. 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 38 years. Retention of future gains is viewed as an important source of funds to sustain the Company's investment activity. Approximately \$64.5 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 (formerly Skylawn Corporation), 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, 2006. For further information see Note 4 and Note 8 of the Consolidated Financial Statements.

Contractual Obligations	Payments Due By Period (\$ in Thousands)				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term debt obligations	\$8,000	--	\$8,000	--	--
Capital lease obligations	--	--	--	--	--
Operating lease obligations	80	--	\$ 80	--	--
Purchase obligations	--	--	--	--	--
Other long-term liabilities reflected on the Company's balance sheet under GAAP	--	--	--	--	--
Total	\$8,080	--	\$8,080	--	--

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 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.

Deferred Income Taxes

In future years, the Company may not qualify or elect to be taxed as a regulated investment company ("RIC") under applicable provisions of the Internal Revenue Code. Therefore, deferred Federal income taxes have been provided on net unrealized appreciation of investments at the then currently effective corporate tax rate on capital gains.

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)

	1996	1997	1998	1999	2000	2001

Financial Position (as of March 31)						
Investments at cost	\$ 58,544	\$ 59,908	\$ 61,154	\$ 73,580	\$ 85,002	\$ 87,602
Unrealized appreciation	198,386	233,383	340,132	276,698	238,627	228,316
	-----	-----	-----	-----	-----	-----
Investments at market or fair value	256,930	293,291	401,286	350,278	323,629	315,918
Total assets	326,972	310,760	522,324	360,786	392,586	322,668
Notes payable *	11,000	5,000	5,000	5,000	10,000	16,000

Deferred taxes on unrealized appreciation	69,121	81,313	118,674	96,473	83,151	79,310
Net assets	189,048	218,972	296,023	256,232	236,876	226,609
Shares outstanding	3,767	3,767	3,788	3,815	3,815	3,815

Changes in Net Assets (years ended March 31)						
Net investment income	\$ 2,855	\$ 2,574	\$ 2,726	\$ 1,762	\$ 1,663	\$ 1,723
Net realized gain (loss) on investments	11,174	6,806	6,485	995	6,020	(3,231)
Net increase (decrease) in unrealized appreciation before distributions	38,746	22,804	69,388	(41,233)	(24,750)	(6,470)
	-----	-----	-----	-----	-----	-----
Increase (decrease) in net assets from operations before distributions	52,775	32,184	78,599	(38,476)	(17,067)	(7,978)
Cash dividends paid	(2,270)	(2,260)	(2,268)	(2,280)	(2,289)	(2,289)
Securities distributed	(9,402)	--	--	--	--	--
Employee stock options exercised	575	--	720	965	--	--
	-----	-----	-----	-----	-----	-----
Increase (decrease) in net assets	41,678	29,924	77,051	(39,791)	(19,356)	(10,267)

Per Share Data (as of March 31)						
Deferred taxes on unrealized appreciation	\$ 18.35	\$ 21.59	\$ 31.33	\$ 25.29	\$ 21.80	\$ 20.79
Net assets	50.18	58.13	78.15	67.16	62.09	59.40
Closing market price	60.00	67.875	94.00	73.00	54.75	65.00
Cash dividends paid .....	.60	.60	.60	.60	.60	.60
Securities distributed	2.50	--	--	--	--	--

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

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

	2002	2003	2004	2005	2006
<hr/>					
Financial Position (as of March 31)					
Investments at cost	\$ 82,194	\$ 91,462	\$ 97,283	\$ 84,546	\$ 88,597
Unrealized appreciation	265,287	195,598	309,666	337,476	461,831
<hr/>					
Investments at market or fair value	347,481	287,060	406,949	422,022	550,428
Total assets	357,183	298,490	423,979	434,384	569,368
Notes payable *	14,000	23,000	20,500	13,000	8,000
<hr/>					
Deferred taxes on unrealized appreciation	92,107	67,790	107,169	117,094	160,764
Net assets	250,491	206,467	290,623	302,534	396,618
Shares outstanding	3,829	3,829	3,857	3,857	3,860
<hr/>					
Changes in Net Assets (years ended March 31)					
Net investment income	\$ 2,042	\$ 2,299	\$ 2,587	\$ 2,406	2,389
Net realized gain (loss) on investments	(538)	1,346	8,192	(6,066)	13,116
Net increase (decrease) in unrealized appreciation before distributions	24,174	(45,372)	74,689	17,885	80,685
<hr/>					
Increase (decrease) in net assets from operations before distributions	25,678	(41,727)	85,468	14,225	96,190
Cash dividends paid	(2,295)	(2,297)	(2,309)	(2,314)	(2,314)
Securities distributed	--	--	--	--	--
Employee stock options exercised	499	--	997	--	208
<hr/>					
Increase (decrease) in net assets	23,882	(44,024)	84,156	11,911	94,084
<hr/>					
Per Share Data (as of March 31)					
Deferred taxes on unrealized appreciation	\$ 24.05	\$ 17.70	\$ 27.79	\$ 30.36	\$ 41.65
Net assets	65.42	53.92	75.35	78.44	102.74
Closing market price	68.75	48.15	75.47	79.10	95.50
Cash dividends paid .....	.60	.60	.60	.60	.60
Securities distributed	--	--	--	--	--

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, 2006. This total does not include an estimated 3,000 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 Stock 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, 2004.....	\$84.28	\$72.68
September 30, 2004.....	81.40	69.55
December 31, 2004.....	80.44	73.00
March 31, 2005.....	79.87	74.25
Quarter Ended	High	Low
June 30, 2005.....	\$89.68	\$74.98
September 30, 2005.....	95.18	81.84
December 31, 2005.....	92.71	82.10
March 31, 2006.....	99.01	89.24

Dividends

The payment dates and amounts of cash dividends per share since April 1, 2004 are as follows:

Payment Date	Cash Dividend
May 28, 2004.....	\$0.20
November 30, 2004.....	0.40
May 31, 2005.....	0.20
November 30, 2005.....	0.40
May 31, 2006.....	0.20

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.

Annual Meeting

The Annual Meeting of Shareholders of Capital Southwest Corporation will be held on Monday, July 17, 2006, 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 -----	State of Incorporation -----
Balco, Inc.	Delaware
Humac Company	Texas
The RectorSeal Corporation	Delaware
Lifemark Group (formerly Skylawn Corporation)	Nevada
The Whitmore Manufacturing Company	Delaware

Exhibit 23.1

Consent of Registered Independent Public Accounting Firm

We have issued our reports dated May 26, 2006, accompanying the consolidated financial statements and management's assessment of the effectiveness of 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, 2006 which are incorporated by reference in the March 31, 2006 Annual Report on Form 10-K of this Registration Statement. We consent to the incorporation by reference of the aforementioned reports in the Registration Statement of Capital Southwest Corporation and subsidiaries on Form S-8 (File No. 33-43881).

/s/ GRANT THORNTON LLP

*May 26, 2006
Dallas, Texas*

Exhibit 23.2

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 33-43881) pertaining to Capital Southwest Corporation of our report dated May 12, 2004, with respect to the consolidated financial statements of Capital Southwest Corporation for the year ended March 31, 2004 included in the March 31, 2006 Annual Report to Shareholders of Capital Southwest Corporation and incorporated by reference in this Annual Report (Form 10-K) for the year ended March 31, 2006.

Ernst & Young LLP

May 24, 2006
Dallas, Texas

Exhibit 31.1

CERTIFICATIONS

I, William R. Thomas, President and Chairman of the Board of Capital Southwest Corporation, 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 26, 2006

By: /s/ William R. Thomas

*William R. Thomas, President and
Chairman of the Board*

Exhibit 31.2

CERTIFICATIONS

I, Susan K. Hodgson, Secretary-Treasurer of Capital Southwest Corporation, 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 26, 2006

By: /s/ Susan K. Hodgson

Susan K. Hodgson, Secretary-Treasurer

Exhibit 32.1

Certification of President and Chairman of the Board

Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code

I, William R. Thomas, President and Chairman of the Board of Capital Southwest Corporation, certify that, to my knowledge:

1. the Form 10-K, filed with the Securities and Exchange Commission on May 26, 2006 ("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 26, 2006

By: /s/ William R. Thomas

*William R. Thomas, President and
Chairman of the Board*

Exhibit 32.2

Certification of Secretary-Treasurer

Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code

I, Susan K. Hodgson, Secretary-Treasurer of Capital Southwest Corporation, certify that, to my knowledge:

1. the Form 10-K, filed with the Securities and Exchange Commission on May 26, 2006 ("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 26, 2006

/s/ Susan K. Hodgson

Susan K. Hodgson, Secretary-Treasurer