

## To Our Shareholders

Net Asset Value at March 31, 2010 was \$486,925,586, equivalent to \$130.14 per share. Assuming reinvestment of all dividends and tax credits on long-term capital gains, the March 31, 2010 net asset value was 18.5% greater than the March 31, 2009 net value of \$110.98 per share and 6.7% above the December 31, 2009 net asset value of \$121.99 per share.

The following table identifies significant sources of the changes in net asset value of each share of Capital Southwest stock during the past year:

|  | Year End<br><u>March 31, 2010</u> |
|--|-----------------------------------|
| Increases (decreases) in unrealized gains: |                                   |
| Alamo Group, Inc .....                     | \$ 5.30                           |
| The RectorSeal Corporation .....           | 3.47                              |
| The Whitmore Manufacturing Company .....   | 3.07                              |
| All Components, Inc .....                  | 2.48                              |
| Heelys, Inc .....                          | 1.57                              |
| Encore Wire Corporation .....              | 0.55                              |
| Media Recovery, Inc. ....                  | (0.37)                            |
| Palm Harbor Homes, Inc .....               | (0.80)                            |
| Other increases .....                      | 3.61                              |
| Net realized gains .....                   | 0.22                              |
| Net investment income .....                | 0.56                              |
| Dividends .....                            | (0.80)                            |
| Other changes in net assets .....          | <u>0.30</u>                       |
| Increases in net asset value .....         | 19.16                             |
| Net asset value beginning of period .....  | <u>110.98</u>                     |
| Net asset value end of period .....        | <u>\$130.14</u>                   |

## Moving Parts

During the year ended March 31, 2010, net unrealized appreciation of investments rose to \$377,920,063 (\$101.00 per share), an increase

of 23.0% from \$307,295,832 (\$82.12 per share) at March 31, 2009. This notable positive change in overall portfolio appreciation of \$70,624,231 (\$18.88 per share) was fairly evenly distributed during the year, as \$37,262,293 (\$9.96 per share) was reported at September 30, 2009, and the balance, \$33,361,938 (\$8.92 per share) occurred during the six months ended March 31, 2010. As reflected elsewhere within this report, net realized gain on investments for the year ended March 31, 2010 was \$825,491, which produced a slight decrease in net unrealized appreciation of investments during the year of \$538,037 (\$0.14 per share).

During the year ended March 31, 2010, investments classified as Controlled Affiliates increased \$23,100,000 in net unrealized appreciation, which was 32.7% of the total \$70,624,231 increase in net unrealized appreciation in investments. The Major Publicly Traded Investments category experienced a net increase in appreciation of \$24,740,433, which represented 35.0% of the total increase in net unrealized appreciation of \$70,624,231.

|                                   | <u>March 31, 2010</u>  |                                  | <u>March 31, 2009</u>  |                                  |
|-----------------------------------|------------------------|----------------------------------|------------------------|----------------------------------|
|                                   | Market<br><u>Value</u> | % of Total<br><u>Investments</u> | Market<br><u>Value</u> | % of Total<br><u>Investments</u> |
| Controlled Affiliates (mainly)    |                        |                                  |                        |                                  |
| The RectorSeal Corporation        | \$120,200,000          | 25.1                             | \$107,200,000          | 27.0                             |
| Lifemark Group                    | 71,000,000             | 14.9                             | 71,000,000             | 17.9                             |
| The Whitmore Manufacturing Co.    | 47,500,000             | 9.9                              | 36,000,000             | 9.1                              |
| Media Recovery, Inc               | 13,400,000             | 2.8                              | 14,800,000             | 3.7                              |
| Major Publicly Traded Investments |                        |                                  |                        |                                  |
| Encore Wire Corporation           | 67,431,375             | 14.1                             | 65,388,000             | 16.5                             |
| Alamo Group, Inc                  | 42,454,500             | 8.9                              | 22,642,400             | 5.7                              |
| Heelys, Inc                       | 19,845,870             | 4.2                              | 13,975,965             | 3.5                              |
| Palm Harbor Homes, Inc            | 6,833,955              | 1.4                              | 9,818,901              | 2.5                              |
| Venture Capital Assets            | 68,262,428             | 14.3                             | 42,023,841             | 10.6                             |
| Marketable Securities             | <u>21,014,929</u>      | <u>4.4</u>                       | <u>13,785,916</u>      | <u>3.5</u>                       |
| Total                             | <u>\$477,943,057</u>   | <u>100.0</u>                     | <u>\$396,635,023</u>   | <u>100.0</u>                     |

In addition to a complete list of our investments, this report includes a description of our twelve largest holdings (see pages 6 through 8).

These twelve investments had a combined cost of \$33,542,228 and a combined value of \$431,648,324, representing 90.3% of the value of our investment portfolio at March 31, 2010.

Regardless of its classification or current form, every security we currently hold originated as a venture capital investment in a private company. Investments in growing, private companies have always been, and continue to be, the essential source of our present holdings.

### Measure of Performance and Value

The following table reflects our Company's performance compared to the S&P 500 Index for the past 5 and 10 years:

| Period Ended   | Investment Returns |                       |
|----------------|--------------------|-----------------------|
|                | *Capital Southwest | **S&P 500 Stock Index |
| March 31, 2010 |                    |                       |
| 5 years        | 6.0%               | 2.0%                  |
| 10 years       | 5.4%               | (0.7)%                |

\* Compounded annual return for Capital Southwest based on net asset value per share assuming reinvestment of all dividends and tax credits.

\*\* Compounded annual return for the S&P 500 Stock Index assuming reinvestment of all dividends.

### Investment Activities

A total of \$17,234,456 was invested during the twelve months ended March 31, 2010 including \$9,000,000 in new holdings and \$8,234,456 in existing holdings. New venture investments include:

- iMemories, Inc. - \$4,000,000. The company provides a convenient means for consumers to maintain and share their home videos, tapes, reels and photos via a complete digitizing process. The resulting online formats can be accessed by family and friends with links to [www.imemories.com](http://www.imemories.com). The service is sold online and in selected retail outlets. The investment is in the form of convertible preferred stock representing a fully diluted potential ownership of 26.2%.

- KBI Biopharma, Inc. - \$5,000,000. This fully integrated contract biopharmaceutical development and manufacturing organization serves large pharmaceutical biotechnology clients. The investment is via Series B convertible preferred stock representing 14.8% of the fully diluted ownership.

Additions to existing investments include contracted capital calls from Ballast Point Ventures II, LP in the amount of \$300,000; BankCap Partners Fund I, LP for \$1,747,156; Cinatra Clean Technologies, Inc. for \$1,737,300; CMI Holding Company, Inc. for \$1,150,000; Discovery Alliance, LLC for \$300,000; and development financing for Palm Harbor Homes, Inc. of \$3,000,000, which was repaid during the period.

Future commitments in these holdings, subject to specific conditions are \$2,325,000 for Ballast Point Ventures II, LP; \$486,163 for BankCap Partners I, LP; \$1,270,000 for Capital-South Partners Fund III, LP; \$200,400 for Cinatra Clean Technologies, Inc.; \$600,000 for CMI Holding Company, Inc.; \$150,000 for Discovery Alliance, LLC; and \$486,900 for Sterling Group Partners I, LP.

Within the Controlled Affiliates category of our portfolio, The RectorSeal Corporation made two strategic acquisitions totaling \$5,200,000 and All Components, Inc. divested its EMS division for \$6,770,000 during the year ended March 31, 2010. Additionally, in the Major Publicly Traded Investment category, Alamo Group, Inc. acquired the assets of Bush Hog, LLC for \$23,950,000 during the year ended March 31, 2010.

Our management and directors think like shareholders because we are. Every \$1.00 we directly invest includes approximately \$0.24 owned by our management and directors. Accordingly our investment decisions are very thoughtful and our monitoring duties are thorough.

## Highlights within the Portfolio

In the spring of 1969, we invested \$600,000 in a shell corporation named Douglass Industries that was created to acquire Engler Manufacturing Co. Engler was a small, slightly emerging organization producing mowers to maintain difficult areas such as highway right-of-ways. As is the case in our typical investment today, the investment was heavily predicated upon the belief that the aspiring entrepreneur, in this case named Don Douglass, could acquire and grow the business. The initial \$600,000 investment and \$200,000 secondary infusion a few months later launched Douglass' business plan and paved the way for Engler of Houston to then become Terrain King Corporation and subsequently become The Alamo Group, Inc. During the next several years we continued to participate as needed in the emerging capitalization of Alamo, which increased our investment to \$2,191,000 as Alamo methodically grew its manufacturing business across the U.S., Canada, Europe and Australia.

Today Alamo, headquartered in Seguin, Texas, is a NYSE company with more than 2,300 employees, operating 18 manufacturing plants with annual sales nearing \$500 million. In the fourth quarter of 2009, Alamo purchased the assets of Bush Hog, the U.S. market leader for commercial sized rotary mowing systems. The combination of Bush Hog with Alamo's Rhino brand of rotary mowers provides a commanding market presence. Furthermore, Alamo's campaigns of aggressive cost containment, synchronization of inventory to demand levels, and labor efficiency have produced a streamlined operating platform. These systems should allow Alamo to extract higher operating profits from the historical base of business, plus provide impressive earnings from the newly acquired Bush Hog business. On a fully diluted basis, Alamo reported first quarter 2010 earnings of \$0.34 per share compared to earnings of \$0.15 per share during the first quarter of 2009.

## Sale of Lifemark Group

On April 29, 2010, we announced that a Stock Purchase Agreement had been executed with NorthStar Memorial Group, LLC whereby NorthStar would acquire 100% of the outstanding common stock of Lifemark Group for \$84.75 million. The transaction is only contingent upon regulatory approval from the licensing and permitting department of the State of California, which is expected to occur during the quarter ended June 30, 2010. We will retain certain real estate previously owned by Lifemark that was held for long term investment purposes, pay the professional transaction costs and retire certain debt owed by Lifemark. We estimate that \$46.2 million of the cash proceeds will be retained for future investment activities and \$24.4 million will be paid in long-term capital gains tax on behalf of our shareholders. Based on an individual tax rate of 15%, it is estimated that individual shareholders will receive a net tax credit of \$3.73 per share effective December 31, 2010 from this transaction. Any additional capital gains or losses we experience during the course of 2010 will alter this amount.

## Preparing for the Future

Glenn Neblett recently joined the Company as a vice president. Glenn received both an accounting degree and an MBA from Baylor University, accumulated public accounting experience with Ernst & Young and spent 13 years in investment banking, with the last ten years as a director with Houlihan Lokey in Dallas and Los Angeles. Glenn's focus will include ongoing business development activities with the Company, securing and executing new venture transactions and providing investment monitoring support at the director level. Glenn will be filling the position vacated by Jeff Peterson, who was repositioned as the CEO of The Whitmore Manufacturing Company in 2009.

Marquez Bela was recruited to a newly created vice president position that will manage the strategic acquisitions of our Controlled Affiliate portfolio companies. Four of our six Controlled Affiliates are judged well positioned to further energize their acquisition programs. Marquez received Bachelors degrees from the University of Texas within the Plan II Honors Program and the Business Honors Program. He began his twelve year investment banking and private equity career with Goldman, Sachs & Co. and gained additional experience with a middle market fund and two boutique investment firms.

These staff additions combined with the expected proceeds from the Lifemark sale, should position Capital Southwest to invest into an improved deal flow during a venture capital cycle that remains depressed. As reported by the National Venture Capital Association in April 2010, venture capital firms across the United States raised 31% less in the first quarter of 2010 than they raised in the first quarter of 2009, representing the slowest quarter since 1993. In May 2010, *Mergers and Acquisitions Report* indicated that the average length of time

General Partners of traditional private equity firms spent fundraising continued to increase. Funds that had closed on fund raises thus far in 2010 took an average of 19 months to finalize the transactions, more than double the timeframe experienced in 2004. While all this may translate into opportunity for us as fewer dollars are chasing increasingly attractive private companies, it also highlights the benefit of our structure that allows our investment staff to focus on investing versus fundraising. Our philosophy and approach allow us to generally operate more efficiently than our peers and pursue superior returns with minimal distraction.

June 7, 2010

Chairman of the Board and President

## Business

Capital Southwest Corporation is one of the nation's largest publicly-owned venture capital investment companies. Since its formation in 1961 and its designation as a business development company in 1988, the Company and its wholly-owned small business investment company subsidiary have provided capital to support the growth of small and medium-sized businesses in varied industries throughout the United States.

Investments are focused on opportunities for capital appreciation derived from expansion financings, management buyouts, recapitalizations, industry consolidations and early-stage financings. The portfolio is a composite of companies in which Capital Southwest Corporation has major interests, as well as a number of developing companies and marketable securities of established publicly traded companies.

### Our Investment Philosophy

- We invest in enterprises believed to have exceptional growth potential.

- We finance those managers who have a proven record of achievement, focused determination, and unquestionable integrity.
- We invest for the long term, which to us means building companies that will lead their industries for many years.
- Unlike most venture capitalists, we do not have an exit strategy that causes successful managers to sell their companies or go public.

These and other investment principles have been forged by our Company's 49 years of experience in providing patient capital and management assistance to those entrepreneurs judged to be capable of building successful businesses with enduring value.

A significant cornerstone of our investment philosophy is our long-term perspective, which has enabled us to hold positions in enterprises destined to achieve accelerating growth after 10, 20 or 30 years. Currently, investments held over 20 years represent approximately 26% of the cost and 76% of the value of our portfolio.

## Twelve Largest Investments – March 31, 2010

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**The RectorSeal Corporation** **\$120,200,000**

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

During the year ended March 31, 2010, RectorSeal earned \$9,571,000 on revenues of \$102,075,000, compared with earnings of \$10,170,000 on revenues of \$112,762,000 in the previous year. RectorSeal's earnings do not reflect its 20% equity in The Whitmore Manufacturing Company.

At March 31, 2010, Capital Southwest owned 100% of RectorSeal's common stock having a cost of \$52,600 and a value of \$120,200,000.

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**Encore Wire Corporation** **\$67,431,375**

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

For the year ended December 31, 2009, Encore reported net income of \$3,636,000 (\$0.16 per share) on net sales of \$649,613,000, compared with net income of \$39,771,000 (\$1.70 per share) on net sales of \$1,081,132,000 in the previous year. The March 31, 2010 closing Nasdaq bid price of Encore's common stock was \$20.80 per share.

At March 31, 2010, 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 \$67,431,375 (\$16.50 per share), representing a fully-diluted equity interest of 17.3%.

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

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Lifemark Group, Hayward, California, owns and operates cemeteries, mausoleums and mortuaries. Lifemark's operations, all of which are in California, include a major cemetery and funeral home in San Mateo, a mausoleum and an adjacent mortuary in Oakland and cemeteries, mausoleums and mortuaries in Hayward and Sacramento. 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, 2010, Lifemark reported earnings of \$716,000 on revenues of \$25,298,000, compared with earnings of \$635,000 on revenues of \$28,193,000 in the previous year.

At March 31, 2010, Capital Southwest owned 100% of Lifemark Group's common stock, which had a cost of \$4,510,400 and was valued at \$71,000,000.

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**The Whitmore Manufacturing Company** **\$47,500,000**

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

During the year ended March 31, 2010, Whitmore reported net income of \$3,661,000 on net sales of \$26,777,000, compared with net income of \$3,209,000 on net sales of \$28,163,000 in the previous year. The company is owned 80% by Capital Southwest and 20% by Capital Southwest's subsidiary, The RectorSeal Corporation (described on this page).

At March 31, 2010, the direct investment in 80% of Whitmore by Capital Southwest was valued at \$47,500,000 and had a cost of \$1,600,000.

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**Alamo Group Inc. \$42,454,500**

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Alamo Group Inc., Seguin, Texas, is a leading designer, manufacturer and distributor of heavy-duty, tractor and truck mounted mowing and other vegetation maintenance equipment, mobile excavators, street-sweeping and snow removal equipment and replacement parts. Founded in 1969, Alamo Group operates 18 manufacturing facilities and serves governmental, industrial and agricultural markets in North America, Europe, and Australia.

For the year ended December 31, 2009, Alamo reported net income of \$17,091,000 (\$1.65 per share) on net sales of \$446,487,000, compared with net income of \$10,999,000 (\$1.11 per share) on net sales of \$557,135,000 in the previous year. The March 31, 2010 closing NYSE market price of Alamo's common stock was \$19.99 per share.

At March 31, 2010, the \$2,190,937 investment in Alamo by Capital Southwest and its subsidiary was valued at \$42,454,500 (\$15.00 per share), consisting of 2,830,300 restricted shares of common stock, representing a fully-diluted equity interest of 22.0%.

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**Media Recovery, Inc. \$13,400,000**

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Media Recovery, Inc. (MRI), Dallas, Texas, is the holding company of DataSpan, ShockWatch and Damage Prevention Company. DataSpan provides datacenter supplies and services to corporate customers through a direct sales force. ShockWatch manufactures and distributes 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, 2009, Media Recovery reported net loss of \$2,626,000 on net sales of \$110,311,000, compared with net income of \$4,354,000 on net sales of \$132,864,000 in the previous year.

At March 31, 2010, the \$5,415,000 investment in Media Recovery by Capital Southwest and its subsidiary was valued at \$13,400,000, consisting of 800,000 shares of Series A Convertible Preferred Stock and 4,000,002 shares of common stock, representing a fully-diluted equity interest of 97.5%.

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**Heelys, Inc. \$19,845,870**

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Heelys, Inc., Carrollton, Texas, designs, markets and distributes branded footwear, equipment and accessories. The company imports its products from China and Korea and distributes them through domestic and international sporting goods chains, department and lifestyle stores and specialty footwear retailers.

During the year ended December 31, 2009, Heelys reported net loss of \$5,125,000 (-\$0.19 per share) on net sales of \$43,777,000, compared with net loss of \$5,924,000 (-\$0.22 per share) on net sales of \$70,741,000 in the previous year. The March 31, 2010 closing Nasdaq bid price of Heely's common stock was \$2.37 per share.

At March 31, 2010, the \$102,490 investment in Heelys by Capital Southwest's subsidiary was valued at \$19,845,870 (\$2.13 per share), consisting of 9,317,310 restricted shares of common stock, representing a fully-diluted equity interest of 31.1%.

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**All Components, Inc. \$12,276,650**

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All Components, Inc., Pflugerville, Texas, distributes and produces memory and other electronic components for personal computer manufacturers, retailers, value-added resellers and other corporate customers. Through its sales and distribution center near Austin, Texas and its distribution center in Miami, Florida, the company serves over 2,000 customers throughout the United States and Latin America.

During the year ended August 31, 2009, All Components reported net income of \$1,863,000 on net sales of \$186,188,000, compared with net income of \$1,167,000 on net sales of \$200,673,000 in the previous year.

At March 31, 2010, the \$6,150,000 investment in All Components by Capital Southwest and its subsidiary was valued at \$12,276,650 consisting of an 8.25% Subordinated Note valued at \$6,454,925 and 150,000 shares of Series A Convertible Preferred Stock valued at \$5,821,725, representing a 80.4% fully-diluted equity interest.

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**Hologic, Inc.** **\$11,726,155**

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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 health-care and general radiographic applications.

For the year ended September 26, 2009, Hologic reported net loss of \$2,176,237,000 (-\$8.48 per share) on net sales of \$1,637,134,000 compared with net loss of \$385,617,000 (-\$1.57 per share) on net sales of \$1,674,499,000 in the previous year. The March 31, 2010 closing Nasdaq bid price of Hologic's common stock was \$18.53 per share.

At March 31, 2010, Capital Southwest and its subsidiary owned 632,820 unrestricted shares of common stock, having a cost of \$220,000 and a market value of \$11,726,155 (\$18.53 per share).

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**Extreme International, Inc.** **\$8,525,000**

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

During the year ended September 30, 2009, Extreme reported net income of \$1,205,000 on net sales of \$11,272,000, compared with net income of \$1,435,000 on net sales of \$11,545,000 in the previous year.

At March 31, 2010, Capital Southwest and its subsidiary owned 39,359 shares of Series C Convertible Preferred Stock, 3,750 shares of 8% Series A Convertible Preferred Stock and 13,035 shares of common stock, having a cost of \$3,325,875 and a market value of \$8,525,000, representing a fully-diluted equity interest of 53.6%.

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**Texas Capital Bancshares, Inc.** **\$9,288,774**

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Texas Capital Bancshares, Inc. of Dallas, Texas, formed in 1998, has total assets of approximately \$5.7 billion. With branch banks in Austin, Dallas, Fort Worth, Houston, Plano and San Antonio, Texas Capital Bancshares conducts its business through its subsidiary, Texas Capital Bank, N.A., which targets middle market commercial and wealthy private client customers in Texas.

For the year ended December 31, 2009, Texas Capital reported net income of \$18,769,000 (\$0.55 per share), compared with net income of \$24,266,000 (\$0.87 per share) in the previous year. The March 31, 2010 closing Nasdaq bid price of Texas Capital's common stock was \$18.97 per share.

At March 31, 2010, Capital Southwest owned 489,656 unrestricted shares of common stock, having a cost of \$3,550,006 and a market value of \$9,288,774 (\$18.97 per share).

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**Balco, Inc.** **\$8,000,000**

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Balco, Inc., Wichita, Kansas, designs and manufactures innovative architectural products used in the construction and remodeling of educational facilities, commercial and industrial buildings, airports, hotels, hospitals, parking garages and high-end residential condominiums. Company products include an extensive line of high quality, standard or custom-engineered expansion joint covers, floor grids and mats, stair nosings, grates and frames and trench and access covers.

During the year ended May 31, 2009, Balco reported net income of \$952,000 on net sales of \$14,651,000, compared with net income of \$841,000 on net sales of \$13,675,000 in the previous year.

At March 31, 2010, the \$624,920 investment in Balco by Capital Southwest was valued at \$8,000,000 consisting of 445,000 shares of common stock and 60,920 shares of Class B non-voting common stock, representing a fully-diluted equity interest of 90.9%.



## Consolidated Schedule of Investments – March 31, 2010

| Company   | Equity (a) | Investment (b)  | Cost   | Value (c)  |
|---|------------|---|--|--|
| †ALAMO GROUP INC.<br>Seguin, Texas<br>Tractor-mounted mowing and mobile excavation equipment for governmental, industrial and agricultural markets; street-sweeping equipment for municipalities.                     | 22.0%      | 2,830,300 shares common stock (acquired 4-1-73 thru 5-25-07)  | \$ 2,190,937   | \$ 42,454,500  |
| <b>ALL COMPONENTS, INC.</b><br>Pflugerville, Texas<br>Electronics contract manufacturing; distribution and production of memory and other components for computer manufacturers, retailers and value-added resellers. | 80.4%      | 8.25% Subordinated Note, \$6,000,000 principal due 2012 (acquired 6-27-07)<br>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)<br>Warrants to purchase 350,000 shares of common stock at \$11.00 per share, expiring 2017 (acquired 6-27-07)   | 6,000,000<br><br>150,000<br><br>—                                    | 6,454,925<br><br>5,821,725<br><br>—                            |
| <b>ATLANTIC CAPITAL BANCSHARES, INC.</b><br>Atlanta, Georgia<br>Holding company of Atlantic Capital Bank, a full service commercial bank.   | 1.9%       | 300,000 shares common stock (acquired 4-10-07)  | 3,000,000  | 3,150,000  |
| ‡BALCO, INC.<br>Wichita, Kansas<br>Specialty architectural products used in the construction and remodeling of commercial and institutional buildings.  | 90.9%      | 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  | 8,000,000  |
| <b>BOXX TECHNOLOGIES, INC.</b><br>Austin, Texas<br>Workstations for computer graphic 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.<br>Richardson, Texas<br>Owns Chase Medical, which develops and sells devices used in cardiac surgery to relieve congestive heart failure; develops and supports cardiac imaging systems.   | 22.4%      | 10% convertible promissory note, due 2013 (acquired 2-23-10)<br>1,631,516 shares Series C-1 Convertible Preferred Stock, convertible into 1,631,516 shares of common stock at \$2.15 per share (acquired 7-10-09)<br>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)<br>Warrants to purchase 109,012 shares of common stock at \$1.72 per share, expiring 2012 (acquired 4-7-04)<br>Warrants to purchase 636,151 shares of Series A-1 Convertible Preferred Stock at \$1.72 per share expiring 2017 and 2019 (acquired 7-2-07 and 6-9-09)<br>Warrant to purchase 90,698 shares of Series D or D-1 Convertible Preferred Stock at \$1.72 per share expiring 2017 (acquired 2-23-10) | 650,000<br><br>2,863,347<br><br>4,000,000<br><br>—<br><br>—<br><br>— | 1,300,000<br><br>2,857,759<br><br>2<br><br>—<br><br>—<br><br>— |
|   |            |   | <u>7,513,347</u>   | <u>4,157,761</u>   |

†Publicly-owned company; ‡Control investment

‡Unrestricted securities as defined in Note (b)

## Consolidated Schedule of Investments – March 31, 2010

| Company  | Equity (a) | Investment (b)   | Cost             | Value (c)        |
|--|------------|--|------------------|------------------|
| <b>CINATRA CLEAN TECHNOLOGIES, INC.</b><br><b>Houston, Texas</b><br>Cleans above ground oil storage tanks with a patented, automated system.   | 59.2%      | 10% Subordinated Secured Promissory Note, \$6,200,000 principal due 2013 (acquired 7-14-08 thru 3-23-10)<br>1,128,649 shares Series A Convertible Preferred Stock, convertible into 1,128,649 shares of common stock at \$1.00 per share (acquired 7-14-08 and 11-19-08)   | \$ 6,000,300     | \$ 3,815,235     |
|  |            |  | <u>1,128,649</u> | <u>1,128,649</u> |
|  |            |  | 7,128,949        | 4,943,884        |
| <b>†ENCORE WIRE CORPORATION</b><br><b>McKinney, Texas</b><br>Electric wire and cable for residential, commercial and industrial construction use.  | 17.3%      | 4,086,750 shares common stock (acquired 7-16-92 thru 10-7-98)  | 5,800,000        | 67,431,375       |
| <b>EXTREME INTERNATIONAL, INC.</b><br><b>Sugar Land, Texas</b><br>Owns Bill Young Productions, Texas Video and Post, and Extreme Communications, which produce radio and television commercials and corporate communications videos. | 53.6%      | 13,035 shares Series A Common Stock (acquired 9-26-08 and 12-18-08)<br>39,359.18 shares Series C Convertible Preferred Stock, convertible into 157,437.72 shares of common stock at \$25.00 per share (acquired 9-30-03)<br>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) | 325,875          | 600,000          |
|  |            |  | 2,625,000        | 7,236,000        |
|  |            |  | <u>375,000</u>   | <u>689,000</u>   |
|  |            |  | 3,325,875        | 8,525,000        |
| <b>¥, †HEELYS, INC.</b><br><b>Carrollton, Texas</b><br>Heelys stealth skate shoes, equipment and apparel sold through sporting goods chains, department stores and footwear retailers.   | 31.1%      | 9,317,310 shares common stock (acquired 5-26-00)   | 102,490          | 19,845,870       |
| <b>†HOLOGIC, INC.</b><br><b>Bedford, Massachusetts</b><br>Medical instruments including bone densitometers, mammography devices and digital radiography systems.   | <1%        | ‡632,820 shares common stock (acquired 8-27-99)  | 220,000          | 11,726,155       |
| <b>IMEMORIES, INC.</b><br><b>Scottsdale, AZ</b><br>Enables online video and photo sharing and DVD creation for home movies recorded in analog and new digital format.  | 26.2%      | 17,391,304 shares Series B Convertible Preferred Stock, convertible into 17,391,304 shares of common stock at \$0.23 per share (acquired 7-10-09)  | 4,000,000        | 4,000,000        |
| <b>KBI BIOPHARMA, INC.</b><br><b>Durham, NC</b><br>Provides fully-integrated, outsourced drug development and bio-manufacturing services.  | 14.8%      | 7,142,857 shares Series B-2 Convertible Preferred Stock, convertible into 7,142,857 shares of common stock at \$0.70 per share (acquired 9-08-09)  | 5,000,000        | 5,000,000        |

†Publicly-owned company; ¥ Control investment

‡Unrestricted securities as defined in Note (b)

## Consolidated Schedule of Investments – March 31, 2010

| Company   | Equity (a) | Investment (b)   | Cost   | Value (c)                                    |
|---|------------|--|--|--|
| <b>¥ LIFEMARK GROUP</b><br><b>Hayward, California</b><br>Cemeteries, mausoleums and mortuaries located in northern California.  | 100.0%     | 1,449,026 shares common stock (acquired 7-16-69)   | \$ 4,510,400                                       | \$ 71,000,000                                |
| <b>¥ MEDIA RECOVERY, INC.</b><br><b>Dallas, Texas</b><br>Computer datacenter and office automation supplies and accessories; impact, tilt monitoring and temperature sensing devices to detect mishandled shipments; dunnage for protecting shipments.                                  | 97.5%      | 800,000 shares Series A Convertible Preferred Stock, convertible into 800,000 shares of common stock at \$1.00 per share (acquired 11-4-97)<br>4,000,002 shares common stock (acquired 11-4-97)  | 800,000<br><u>4,615,000</u><br>5,415,000           | 2,200,000<br><u>11,200,000</u><br>13,400,000 |
| <b>PALLETONE, INC.</b><br><b>Bartow, Florida</b><br>Manufacturer of wooden pallets and pressure-treated lumber.   | 8.4%       | 12.3% senior subordinated notes, \$2,000,000 principal due 2012 (acquired 9-25-06)<br>150,000 shares common stock (acquired 10-18-01)<br>Warrant to purchase 15,294 shares of common stock at \$1.00 per share, expiring 2011 (acquired 2-17-06) | 1,553,150<br>150,000<br><u>45,746</u><br>1,748,896 | 2,000,000<br>2<br>—<br><u>2,000,002</u>      |
| <b>¥, † PALM HARBOR HOMES, INC.</b><br><b>Dallas, Texas</b><br>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)<br>Warrant to purchase 286,625 shares of common stock at \$3.14 per share, expiring 2019 (acquired 4-24-09)   | 10,931,955<br>—<br><u>10,931,955</u>               | 6,833,955<br>—<br><u>6,833,955</u>           |
| <b>¥ THE RECTORSEAL CORPORATION</b><br><b>Houston, Texas</b><br>Specialty chemicals for plumbing, HVAC, electrical, construction, industrial, oil field and automotive applications; smoke containment systems for building fires; also owns 20% of The Whitmore Manufacturing Company. | 100.0%     | 27,907 shares common stock (acquired 1-5-73 and 3-31-73)   | 52,600   | 120,200,000                                  |
| <b>TCI HOLDINGS, INC.</b><br><b>Denver, Colorado</b><br>Cable television systems and microwave relay systems.   | —          | 21 shares 12% Series C Cumulative Compounding Preferred Stock (acquired 1-30-90)   | —  | 677,250                                      |
| <b>† TEXAS CAPITAL BANCSHARES, INC.</b><br><b>Dallas, Texas</b><br>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  | 9,288,774                                    |

† Publicly-owned company; ¥ Control investment

± Unrestricted securities as defined in Note (b)

## Consolidated Schedule of Investments – March 31, 2010

| Company  | Equity (a) | Investment (b)   | Cost                                     | Value (c)            |
|--|------------|--|--|----------------------|
| <b>TRAX HOLDINGS, INC.</b><br><b>Scottsdale, Arizona</b><br>Provides a comprehensive set of solutions to improve the transportation validation, accounting, payment and information management process.                    | 31.1%      | 1,061,279 shares Series A Convertible Preferred Stock, convertible into 1,061,279 common stock at \$4.71 per share (acquired 12-8-08 and 2-17-09)                              | \$ 5,000,000                             | \$ 5,687,669         |
| <b>VIA HOLDINGS, INC.</b><br><b>Sparks, Nevada</b><br>Designer, manufacturer and distributor of high-quality office seating.   | 28.1%      | 9,118 shares Series B Preferred Stock (acquired 9-19-05)<br>1,118 shares Series C Preferred Stock (acquired 11-1-07)   | 4,559,000<br><u>281,523</u><br>4,840,523 | 2<br><u>2</u><br>4   |
| <b>WELLOGIX, INC.</b><br><b>Houston, Texas</b><br>Developer and supporter of software used by the oil and gas industry.  | 19.6%      | 4,788,371 shares Series A-1 Convertible Participating Preferred Stock, convertible into 4,788,371 shares of common stock at \$1.0441 per share (acquired 8-19-05 thru 6-15-08) | 5,000,000                                | 2                    |
| ‡ <b>THE WHITMORE MANUFACTURING COMPANY</b><br><b>Rockwall, Texas</b><br>Specialized surface mining, railroad and industrial lubricants; coatings for automobiles and primary metals; fluid contamination control devices. | 80.0%      | 80 shares common stock (acquired 8-31-79)  | 1,600,000                                | 47,500,000           |
| <b>MISCELLANEOUS</b>   | –          | Ballast Point Ventures II, L.P. – 2.6% limited partnership interest (acquired 8-4-08 thru 11-3-09)   | 675,000                                  | 675,000              |
|  | –          | BankCap Partners Fund I, L.P. – 6.0% limited partnership interest (acquired 7-14-06 thru 6-18-09)  | 5,513,837                                | 5,179,842            |
|  | –          | CapitalSouth Partners Fund III, L.P. – 2.0% limited partnership interest (acquired 1-22-08 and 2-12-09)  | 831,256                                  | 831,256              |
|  | –          | Diamond State Ventures, L.P. – 1.8% limited partnership interest (acquired 10-12-99 thru 8-26-05)  | 76,000                                   | 186,852              |
|  | –          | ‡ Discovery Alliance, LLC – 90.0% limited liability company (acquired 9-12-08 thru 3-12-10)  | 750,000                                  | 750,000              |
|  | –          | Essex Capital Corporation – 10% unsecured promissory note due 8-19-11 (acquired 8-16-09)   | –  | 1,000,000            |
|  | –          | First Capital Group of Texas III, L.P. – 3.0% limited partnership interest (acquired 12-26-00 thru 8-12-05)  | 778,895                                  | 451,208              |
|  | 100.0%     | ‡ Humac Company – 1,041,000 shares common stock (acquired 1-31-75 and 12-31-75)  | –  | 163,000              |
|  | –          | 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)  | 950,000                                  | 1                    |
|  | –          | Sterling Group Partners I, L.P. – 1.6% limited partnership interest (acquired 4-20-01 thru 1-24-05)  | 1,064,042                                | 607,044              |
| <b>TOTAL INVESTMENTS</b>   |            |  | <b>\$100,022,994</b>                     | <b>\$477,943,057</b> |

†Publicly-owned company; ‡Control investment

‡Unrestricted securities as defined in Note (b)

## Consolidated Schedule of Investments – March 31, 2009

| Company  | Equity (a) | Investment (b)   | Cost  | Value (c)   |
|--|------------|--|---|---|
| †ALAMO GROUP INC.<br><b>Seguin, Texas</b><br>Tractor-mounted mowing and mobile excavation equipment for governmental, industrial and agricultural markets; street-sweeping equipment for municipalities.                   | 26.0%      | 2,830,300 shares common stock (acquired 4-1-73 thru 5-25-07)   | \$ 2,190,937  | \$ 22,642,400                                     |
| <b>ALL COMPONENTS, INC.</b><br><b>Austin, Texas</b><br>Electronics contract manufacturing; distribution and production of memory and other components for computer manufacturers, retailers and value-added resellers.     | 80.0%      | 8.25% Subordinated Note due 2012 (acquired 6-27-07)<br>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)<br>Warrants to purchase 350,000 shares of common stock at \$11.00 per share, expiring 2017 (acquired 6-27-07)   | 6,000,000<br><br>150,000<br><br>—<br>6,150,000            | 3,000,000<br><br>1<br><br>—<br>3,000,001          |
| <b>ATLANTIC CAPITAL BANCSHARES, INC.</b><br><b>Atlanta, Georgia</b><br>Holding company of Atlantic Capital Bank a full service commercial bank.  | 2.0%       | 300,000 shares common stock (acquired 4-10-07)   | 3,000,000   | 3,000,000   |
| †BALCO, INC.<br><b>Wichita, Kansas</b><br>Specialty architectural products used in the construction and remodeling of commercial and institutional buildings.  | 90.9%      | 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   | 6,600,000   |
| <b>BOXX TECHNOLOGIES, INC.</b><br><b>Austin, Texas</b><br>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.<br><b>Richardson, Texas</b><br>Owns Chase Medical, which develops and sells devices used in cardiac surgery to relieve congestive heart failure; develops and supports cardiac imaging systems. | 15.3%      | 10% Convertible Subordinated Note, due 2009 (acquired 7-2-07 thru 10-9-07)<br>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)<br>Warrants to purchase 109,012 shares of common stock at \$1.72 per share, expiring 2012 (acquired 4-7-04)<br>Warrant to purchase 431,982 shares of Series A-1 Convertible Preferred Stock at \$1.72 per share expiring 2017 (acquired 7-2-07) | 2,363,347<br><br>4,000,000<br><br>—<br><br>—<br>6,363,347 | 1,000,000<br><br>2<br><br>—<br><br>—<br>1,000,002 |

†Publicly-owned company; ‡Control investment

‡Unrestricted securities as defined in Note (b)

## Consolidated Schedule of Investments – March 31, 2009

| Company  | Equity (a) | Investment (b)   | Cost             | Value (c)        |
|--|------------|--|------------------|------------------|
| <b>CINATRA CLEAN TECHNOLOGIES, INC.</b><br><b>Houston, Texas</b><br>Cleans above ground oil storage tanks with a patented, automated system.   | 59.2%      | 10% subordinated secured promissory note (acquired 7-14-08 thru 12-8-08)<br>1,128,649 shares Series A Convertible Preferred Stock, convertible into 1,128,649 shares of common stock at \$1.00 per share (acquired 7-14-08 and 11-19-08)   | \$ 4,263,000     | \$ 4,263,000     |
|  |            |  | <u>1,128,649</u> | <u>1,128,649</u> |
|  |            |  | 5,391,649        | 5,391,649        |
| <b>‡ DENNIS TOOL COMPANY</b><br><b>Houston, Texas</b><br>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)<br>140,137 shares common stock (acquired 3-7-94 and 8-10-98)  | 999,981          | 999,981          |
|  |            |  | <u>2,329,963</u> | <u>2,868,000</u> |
|  |            |  | 3,329,944        | 3,867,981        |
| <b>† ENCORE WIRE CORPORATION</b><br><b>McKinney, Texas</b><br>Electric wire and cable for residential, commercial and industrial construction use.   | 17.2%      | 4,086,750 shares common stock (acquired 7-16-92 thru 10-7-98)  | 5,800,000        | 65,388,000       |
| <b>EXTREME INTERNATIONAL, INC.</b><br><b>Sugar Land, Texas</b><br>Owns Bill Young Productions, Texas Video and Post, and Extreme Communications, which produce radio and television commercials and corporate communications videos. | 53.6%      | 13,035 shares Series A common stock (acquired 9-26-08 and 12-18-08)<br>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)<br>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) | 325,875          | 463,850          |
|  |            |  | 2,625,000        | 5,602,376        |
|  |            |  | <u>375,000</u>   | <u>533,774</u>   |
|  |            |  | 3,325,875        | 6,600,000        |
| <b>‡, † HEELYS, INC.</b><br><b>Carrollton, Texas</b><br>Heelys stealth skate shoes, equipment and apparel sold through sporting goods chains, department stores and footwear retailers.  | 31.1%      | 9,317,310 shares common stock (acquired 5-26-00)   | 102,490          | 13,975,965       |
| <b>† HOLOGIC, INC.</b><br><b>Bedford, Massachusetts</b><br>Medical instruments including bone densitometers, mammography devices and digital radiography systems.  | <1%        | ‡632,820 shares common stock (acquired 8-27-99)  | 220,000          | 8,277,286        |
| <b>‡ LIFEMARK GROUP</b><br><b>Hayward, California</b><br>Cemeteries, mausoleums and mortuaries located in northern California.   | 100.0%     | 1,449,026 shares common stock (acquired 7-16-69)   | 4,510,400        | 71,000,000       |

†Publicly-owned company; ‡ Control investment

‡Unrestricted securities as defined in Note (b)

## Consolidated Schedule of Investments – March 31, 2009

| Company   | Equity (a) | Investment (b)  | Cost   | Value (c)                                       |
|---|------------|---|--|---|
| <b>¥ MEDIA RECOVERY, INC.</b><br><b>Dallas, Texas</b><br>Computer datacenter and office automation supplies and accessories; impact, tilt monitoring and temperature sensing devices to detect mishandled shipments; dunnage for protecting shipments.                                  | 97.1%      | 800,000 shares Series A Convertible Preferred Stock, convertible into 800,000 shares of common stock at \$1.00 per share (acquired 11-4-97)<br>4,000,002 shares common stock (acquired 11-4-97)                           | \$ 800,000<br><u>4,615,000</u><br>5,415,000        | \$ 2,500,000<br><u>12,300,000</u><br>14,800,000 |
| <b>PALLETONE, INC.</b><br><b>Bartow, Florida</b><br>Manufacturer of wooden pallets and pressure-treated lumber.   | 8.5%       | 12.3% Senior Subordinated Notes due 2012 (acquired 9-25-06)<br>150,000 shares common stock (acquired 10-18-01)<br>Warrant to purchase 15,294 shares of common stock at \$1.00 per share, expiring 2011 (acquired 2-17-06) | 1,553,150<br>150,000<br><u>45,746</u><br>1,748,896 | 2<br>2<br>—<br>4                                |
| <b>¥, † PALM HARBOR HOMES, INC.</b><br><b>Dallas, Texas</b><br>Integrated manufacturing, retailing, financing and insuring of manufactured housing and modular homes.   | 31.5%      | 7,855,121 shares common stock (acquired 1-3-85 thru 7-31-95)  | 10,931,955   | 9,818,902                                       |
| <b>¥ THE RECTORSEAL CORPORATION</b><br><b>Houston, Texas</b><br>Specialty chemicals for plumbing, HVAC, electrical, construction, industrial, oil field and automotive applications; smoke containment systems for building fires; also owns 20% of The Whitmore Manufacturing Company. | 100.0%     | 27,907 shares common stock (acquired 1-5-73 and 3-31-73)  | 52,600   | 107,200,000                                     |
| <b>TCI HOLDINGS, INC.</b><br><b>Denver, Colorado</b><br>Cable television systems and microwave relay systems.   | —          | 21 shares 12% Series C Cumulative Compounding Preferred Stock (acquired 1-30-90)  | —  | 677,250   |
| <b>† TEXAS CAPITAL BANCSHARES, INC.</b><br><b>Dallas, Texas</b><br>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  | 5,508,630                                       |
| <b>TRAX HOLDINGS, INC.</b><br><b>Scottsdale, Arizona</b><br>Provides a comprehensive set of solutions to improve the transportation validation, accounting, payment and information management process.   | 32.5%      | 1,061,279 shares Series A Convertible Preferred Stock, convertible into 1,061,279 common stock at \$4.71 per share (acquired 12-8-08 and 2-17-09)   | 5,000,000  | 5,000,000                                       |
| <b>VIA HOLDINGS, INC.</b><br><b>Sparks, Nevada</b><br>Designer, manufacturer and distributor of high-quality office seating.  | 28.1%      | 9,118 shares Series B Preferred Stock (acquired 9-19-05)<br>1,118 shares Series C Preferred Stock (acquired 11-1-07)  | 4,559,000<br><u>281,523</u><br>4,840,523           | 2<br><u>2</u><br>4                              |

†Publicly-owned company; ¥ Control investment

‡Unrestricted securities as defined in Note (b)

## Consolidated Schedule of Investments – March 31, 2009

| Company  | Equity (a) | Investment (b)   | Cost                       | Value (c)                   |
|--|------------|--|----------------------------|-----------------------------|
| <b>WELLOGIX, INC.</b><br><b>Houston, Texas</b><br>Developer and supporter of software used by the oil and gas industry.  | 19.9%      | 4,788,371 shares Series A-1 Convertible Participating Preferred Stock, convertible into 4,788,371 shares of common stock at \$1.0441 per share (acquired 8-19-05 thru 6-15-08) | \$ 5,000,000               | \$ 2                        |
| ‡ <b>THE WHITMORE MANUFACTURING COMPANY</b><br><b>Rockwall, Texas</b><br>Specialized surface mining, railroad and industrial lubricants; coatings for automobiles and primary metals; fluid contamination control devices. | 80.0%      | 80 shares common stock (acquired 8-31-79)  | 1,600,000                  | 36,000,000                  |
| <b>MISCELLANEOUS</b>   |            |  |                            |                             |
|  | –          | Ballast Point Ventures II, L.P. – 2.6% limited partnership interest (acquired 8-4-08 thru 10-24-08)  | 375,000                    | 375,000                     |
|  | –          | BankCap Partners Fund I, L.P. – 6.0% limited partnership interest (acquired 7-14-06 thru 10-10-08)   | 3,766,681                  | 3,766,681                   |
|  | –          | CapitalSouth Partners Fund III, L.P. – 2.8% limited partnership interest (acquired 1-22-08 and 2-12-09)  | 831,256                    | 831,256                     |
|  | –          | Diamond State Ventures, L.P. – 1.9% limited partnership interest (acquired 10-12-99 thru 8-26-05)  | 111,000                    | 111,000                     |
|  | –          | ‡ Discovery Alliance, LLC – 90.0% limited liability company (acquired 9-12-08 thru 3-1-09)   | 450,000                    | 450,000                     |
|  | –          | First Capital Group of Texas III, L.P. – 3.0% limited partnership interest (acquired 12-26-00 thru 8-12-05)  | 964,604                    | 840,260                     |
|  | 100.0%     | ‡ Humac Company – 1,041,000 shares common stock (acquired 1-31-75 and 12-31-75)  | –                          | 133,000                     |
|  | –          | 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)  | 950,000                    | 1                           |
|  | –          | Sterling Group Partners I, L.P. – 1.7% limited partnership interest (acquired 4-20-01 thru 1-24-05)  | 1,064,042                  | 379,746                     |
| <b>TOTAL INVESTMENTS</b>   |            |  | <b><u>\$89,339,191</u></b> | <b><u>\$396,635,023</u></b> |

†Publicly-owned company; ‡ Control investment

‡Unrestricted securities as defined in Note (b)



## Notes to Consolidated Schedule of Investments

### (a) Equity

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

### (b) Investments

**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, 2010, restricted securities represented approximately 95.6% of the value of the consolidated investment portfolio.

Our investments are carried at fair value in accordance with the Investment Company Act of 1940 (the "1940 Act") and FASB Accounting Standards Codification™ (ASC) Topic 820, Fair Value Measurements and Disclosures. In accordance with the 1940 Act, unrestricted minority-owned publicly traded securities, for which the market quotations are readily available, are valued at the closing sale price for the NYSE listed securities and the lower of the closing bid price or the last sale price for NASDAQ securities on the valuation date; and restricted publicly traded securities and other privately held securities are valued as determined in good faith by our Board of Directors.

We adopted FASB ASC Topic 820 on April 1, 2008 (see footnote 1 in "Notes to Consolidated Financial Statements," page 25). ASC Topic

820 provides a framework for measuring the fair value of assets and liabilities along with guidance regarding a fair value hierarchy, which prioritizes information used to measure fair value and the effect of fair value measurements on earnings and provides for enhanced disclosures determined by the level within the hierarchy of information used for valuation.

ASC Topic 820 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. ASC Topic 820 defines fair value in terms of the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the "exit price") and excludes transaction costs. Under ASC Topic 820, the fair value measurement also assumes that the transaction to sell an asset occurs in the principal market for the asset or, in the absence of a principal market, the most advantageous market for the asset. The principal market is the market in which the reporting entity would sell or transfer the asset with the greatest volume and level of activity for the asset. In determining the principal market for an asset or liability under ASC, it is assumed that the reporting entity has access to the market as of the measurement date. Our Board of Directors retained Duff & Phelps to provide limited scope third party valuation services on eight investments comprising 81.3% of our net asset value at March 31, 2010. Please refer to our Form 10-K for full disclosure of Duff & Phelps' services.

### (c) Value

**Debt Securities** are generally valued on the basis of the price the security would command in order to provide a yield-to-maturity equivalent to the present yield of comparable debt instruments of similar quality. Issuers whose debt securities are judged to be of poor quality and doubtful collectability may instead be valued by assigning major

percentage discounts commensurate with the quality of such debt securities. Debt securities may also be valued based on the resulting value from the sale of the business at the estimated fair market value.

**Partnership Interests, Preferred Equity and Common Equity**

including unrestricted marketable securities, which are valued at the closing sale price for the NYSE listed securities and the lower of the closing bid price or the last sale price for NASDAQ securities on the valuation date, and restricted marketable securities for which there is a public market, are valued at the closing sale price for the NYSE listed securities and the lower of the closing bid price or the last sale price for NASDAQ securities on the valuation date, adjusted in good faith by our Board of Directors if they deem a discount or premium would be likely or obtainable upon a sale or transfer of our interest. For those without a principal market, the Board of Directors considers 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; protective put analysis based on the Black-Scholes option pricing model; 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. Investments, in certain entities that calculate net asset value per share (or its equivalent) and for which fair market value is not readily determinable, are valued using the net asset value per share (or its equivalent, such as member units or ownership interest in partners' capital to which a proportionate share of net assets is attributed) of the investment.

**Equity Warrants** are valued on the basis of accepted formulas derived from empirical studies which define the market value of a war-

rant in relation to the market price of its common stock. These formulas measure the "option value" of a warrant as well as its "exercise value" (the amount, if any, by which the value of the stock exceeds the exercise price of the warrant). In applying such formulas, the market price of the stock is usually discounted to reflect the fact that the stock is restricted and the calculated value is of the warrant itself may be discounted (if deemed appropriate) to reflect its restrictive nature. Generally, the option value is excluded if the formula indicates (i) the warrant expires within six months, (ii) the market price of the stock (discounted) is less than one-half of the exercise price of the warrant, or (iii) the market price of the stock (discounted) is more than two times the amount of the exercise price of the warrant.

(d) Agreements between certain issuers and the Company provide that the issuers will bear substantially all costs in connection with the disposition of common stock, including those costs involved in registration under the Securities Act of 1933, but excluding underwriting discounts and commissions. These agreements cover common stock owned at March 31, 2010 and common stock which may be acquired thereafter through the exercise of warrants and conversion of debentures and preferred stock. They apply to restricted securities of all issuers in the investment portfolio of the Company except securities of the following issuers, which are not obligated to bear registration costs: Humac Company, Lifemark Group and The Whitmore Manufacturing Company.

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

## Portfolio Changes During the Year

### New Investments and Additions to Previous Investments

|                                      | <u>Amount</u>       |
|--------------------------------------|---------------------|
| Ballast Point Ventures II, L.P.....  | \$ 300,000          |
| BankCap Partners Fund I, L.P.....    | 1,747,156           |
| Cinatra Clean Technologies, Inc..... | 1,737,300           |
| CMI Holding Company, Inc.....        | 1,150,000           |
| Discovery Alliance, LLC.....         | 300,000             |
| iMemories, Inc.....                  | 4,000,000           |
| KBI Biopharma, Inc.....              | 5,000,000           |
| Palm Harbor Homes, Inc.....          | 3,000,000           |
|                                      | <u>\$17,234,456</u> |

### Dispositions

|                                    | <u>Cost</u>        | <u>Amount<br/>Received</u> |
|------------------------------------|--------------------|----------------------------|
| Dennis Tool Company .....          | \$3,329,944        | \$4,763,416                |
| Diamond State Ventures .....       | 35,000             | 35,000                     |
| Essex Capital Corporation .....    | -                  | 206,522                    |
| First Capital Group of Texas ..... | <u>185,709</u>     | <u>185,709</u>             |
|                                    | <u>\$3,550,653</u> | <u>\$5,190,647</u>         |
| <b>Repayments Received .....</b>   |                    | <u>\$3,000,000</u>         |

**Capital Southwest Corporation and Subsidiaries**  
**Consolidated Statements of Assets and Liabilities**

| <b>Assets</b>                       | March 31             |                      | <b>Liabilities</b>                           | March 31             |                      |
|-------------------------------------|----------------------|----------------------|--|----------------------|----------------------|
|                                     | 2010                 | 2009                 |  | 2010                 | 2009                 |
| Investments at market or fair value |                      |                      | Other liabilities .....                      | \$ 1,070,540         | \$ 253,294           |
| Companies more than 25% owned       |                      |                      | Pension liability .....                      | 1,082,941            | 934,427              |
| (Cost: 2010 – \$26,178,302,         |                      |                      | Deferred income taxes .....                  | <u>2,095,518</u>     | <u>1,092,427</u>     |
| 2009 - \$29,208,246) .....          | \$330,147,325        | \$286,488,248        | Total liabilities.....                       | <u>4,248,999</u>     | <u>2,280,148</u>     |
| Companies 5% to 25% owned           |                      |                      | <b>Net Assets</b>                            |                      |                      |
| (Cost: 2010 – \$21,562,243,         |                      |                      | Common stock, \$1 par value: authorized,     |                      |                      |
| 2009 - \$20,412,243) .....          | 73,589,142           | 66,388,010           | 5,000,000 shares; issued, 4,326,516          |                      |                      |
| Companies less than 5% owned        |                      |                      | shares at March 31, 2010 and                 |                      |                      |
| (Cost: 2010 – \$52,282,449,         |                      |                      | March 31, 2009 .....                         | 4,326,516            | 4,326,516            |
| 2009 - \$39,718,702) .....          | <u>74,206,590</u>    | <u>43,758,765</u>    | Additional capital.....                      | 126,554,546          | 124,571,029          |
| Total investments                   |                      |                      | Undistributed net investment income ..       | 2,061,109            | 2,963,640            |
| (Cost: 2010 – \$100,022,994,        |                      |                      | Undistributed net realized gain on           |                      |                      |
| 2009 – \$89,339,191) .....          | 477,943,057          | 396,635,023          | Investments.....                             | -                    | 42,622               |
| Cash and cash equivalents.....      | 4,093,508            | 14,721,730           | Unrealized appreciation of investments ..... | 377,920,063          | 307,295,832          |
| Receivables                         |                      |                      | Treasury stock – at cost 584,878 shares      |                      |                      |
| Dividends and interest .....        | 1,012,782            | 498,506              | at March 31, 2010 and March 31,2009 .....    | <u>(23,936,648)</u>  | <u>(23,936,648)</u>  |
| Affiliates .....                    | 864,943              | 16,706               | Total net assets .....                       | <u>486,925,586</u>   | <u>415,262,991</u>   |
| Pension assets .....                | 7,068,957            | 5,468,861            | Total liabilities and net assets .....       | <u>\$491,174,585</u> | <u>\$417,543,139</u> |
| Other assets .....                  | <u>191,338</u>       | <u>202,313</u>       | Net assets value per share                   |                      |                      |
| Total assets .....                  | <u>\$491,174,585</u> | <u>\$417,543,139</u> | (on the 3,741,638 shares outstanding) .....  | <u>\$ 130.14</u>     | <u>\$ 110.98</u>     |

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

## Capital Southwest Corporation and Subsidiaries

### Consolidated Statements of Operations

|  | Years Ended March 31 |                        |                        |
|--|----------------------|------------------------|------------------------|
|  | 2010                 | 2009                   | 2008                   |
| Investment income (see note 9):  |                      |                        |                        |
| Interest .....   | \$ 1,044,867         | \$ 1,375,215           | \$ 2,255,550           |
| Dividends.....   | 3,788,680            | 11,533,878             | 3,656,833              |
| Management and directors' fees.....  | <u>1,275,759</u>     | <u>1,076,039</u>       | <u>882,300</u>         |
|  | <u>6,109,306</u>     | <u>13,985,132</u>      | <u>6,794,683</u>       |
| Operating expenses:  |                      |                        |                        |
| Salaries .....   | 2,839,070            | 2,294,187              | 1,619,008              |
| Net pension benefit.....   | (369,108)            | (253,229)              | (327,345)              |
| Stock option expense .....   | 675,210              | 503,645                | 263,664                |
| Professional fees .....  | 551,112              | 689,425                | 798,172                |
| Other operating expenses.....  | <u>207,224</u>       | <u>431,473</u>         | <u>614,824</u>         |
|  | <u>3,903,508</u>     | <u>3,665,501</u>       | <u>2,968,323</u>       |
| Income before income taxes .....   | 2,205,798            | 10,319,631             | 3,826,360              |
| Income tax expense .....   | <u>115,017</u>       | <u>136,176</u>         | <u>111,160</u>         |
| <b>Net investment income</b> .....   | <u>\$ 2,090,781</u>  | <u>\$ 10,183,455</u>   | <u>\$ 3,715,200</u>    |
| Proceeds from disposition of investments .....                                 | \$ 5,190,647         | \$ 20,697,647          | \$ 1,433,891           |
| Cost of investments sold .....   | <u>3,550,653</u>     | <u>4,718,381</u>       | <u>1,193,867</u>       |
| Net realized gain on investments before income taxes.....                      | 1,639,994            | 15,979,266             | 240,024                |
| Income tax expense .....   | <u>814,503</u>       | <u>5,222,964</u>       | <u>-</u>               |
| <b>Net realized gain on investments</b> .....                                  | <u>825,491</u>       | <u>10,756,302</u>      | <u>240,024</u>         |
| <b>Net increase (decrease) in unrealized appreciation of investments</b> ..... | <u>70,624,231</u>    | <u>(159,247,203)</u>   | <u>(142,969,698)</u>   |
| <b>Net realized and unrealized gain (loss) on investments</b> .....            | <u>\$71,449,722</u>  | <u>\$(148,490,901)</u> | <u>\$(142,729,674)</u> |
| <b>Increase (decrease) in net assets from operations</b> .....                 | <u>\$73,540,503</u>  | <u>\$(138,307,446)</u> | <u>\$(139,014,474)</u> |

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

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

|   | Years Ended March 31        |                             |                             |
|---|-----------------------------|-----------------------------|-----------------------------|
|   | 2010                        | 2009                        | 2008                        |
| Operations:   |                             |                             |                             |
| Net investment income .....   | \$ 2,090,781                | \$ 10,183,455               | \$ 3,715,200                |
| Net realized gain on investments .....                                  | 825,491                     | 10,756,302                  | 240,024                     |
| Net increase (decrease) in unrealized appreciation of investments ..... | <u>70,624,231</u>           | <u>(159,247,203)</u>        | <u>(142,969,698)</u>        |
| Increase (decrease) in net assets from operations .....                 | 73,540,503                  | (138,307,446)               | (139,014,474)               |
| Distributions from:   |                             |                             |                             |
| Undistributed net investment income .....                               | (2,993,310)                 | (12,256,745)                | (2,333,291)                 |
| Net realized gains deemed distribution to shareholders .....            | (868,114)                   | (8,646,560)                 | -                           |
| Capital share transactions:   |                             |                             |                             |
| Allocated increase in share value for deemed distribution .....         | 868,114                     | 8,646,560                   | -                           |
| Exercise of employee stock options .....                                | -                           | -                           | 231,390                     |
| Change in pension plan funded status, net of tax .....                  | 440,192                     | (1,473,329)                 | (1,178,764)                 |
| Stock option expense .....  | 675,210                     | 503,645                     | 263,664                     |
| Treasury stock .....  | -                           | <u>(16,903,346)</u>         | -                           |
| Increase (decrease) in net assets .....                                 | 71,662,595                  | (168,437,221)               | (142,031,475)               |
| Net assets, beginning of year .....                                     | <u>415,262,991</u>          | <u>583,700,212</u>          | <u>725,731,689</u>          |
| <b>Net assets, end of year .....</b>                                    | <b><u>\$486,925,586</u></b> | <b><u>\$415,262,991</u></b> | <b><u>\$583,700,214</u></b> |

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

## Capital Southwest Corporation and Subsidiaries

### Consolidated Statements of Cash Flows

|  | Years Ended March 31 |                      |                      |
|--|----------------------|----------------------|----------------------|
|  | 2010                 | 2009                 | 2008                 |
| <b>Cash flows from operating activities</b>                                      |                      |                      |                      |
| Increase (decrease) in net assets from operations .....                          | \$ 73,540,503        | \$(138,307,446)      | \$(139,014,474)      |
| Adjustments to reconcile increase (decrease) in net assets from operations ..... |                      |                      |                      |
| to net cash provided by (used in) operating activities:                          |                      |                      |                      |
| Proceeds from disposition of investments .....                                   | 5,190,647            | 20,697,647           | 1,433,891            |
| Proceeds from repayment of debt securities .....                                 | 3,000,000            | -                    | -                    |
| Purchases of securities .....  | (17,234,456)         | (13,030,107)         | (10,733,536)         |
| Maturities of securities .....   | -                    | -                    | 154,500              |
| Depreciation and amortization .....  | 33,130               | 40,478               | 32,756               |
| Net pension benefit .....  | (369,108)            | (253,229)            | (327,345)            |
| Net realized (gain) loss on investments before income taxes .....                | (825,491)            | (10,756,302)         | (240,024)            |
| Net (increase) decrease in unrealized appreciation of investments .....          | (70,624,231)         | 159,247,203          | 142,969,698          |
| Stock option expense .....   | 675,210              | 503,645              | 263,664              |
| Increase in dividend and interest receivable .....                               | (514,278)            | (364,160)            | 190,275              |
| (Increase) decrease in receivables from affiliates .....                         | (617,026)            | 5,270                | (8,705)              |
| Increase in other assets .....   | (22,155)             | (33,358)             | (80,195)             |
| Increase (decrease) in other liabilities .....                                   | 817,246              | 7,620                | (33,281)             |
| Decrease in accrued pension cost .....   | -                    | (68,934)             | (135,768)            |
| Increase in deferred income taxes .....  | 129,600              | 88,700               | 114,000              |
| Net cash provided by (used in) operating activities .....                        | <u>(6,820,409)</u>   | <u>17,777,027</u>    | <u>(5,414,544)</u>   |
| <b>Cash flows from financing activities</b>                                      |                      |                      |                      |
| Distributions from undistributed net investment income .....                     | (2,993,310)          | (12,256,745)         | (2,333,291)          |
| Proceeds from exercise of employee stock options .....                           | -                    | -                    | 231,390              |
| Purchase of treasury stock .....   | -                    | (16,903,346)         | -                    |
| Payment of federal income tax for deemed capital gains distribution .....        | (814,503)            | (5,222,964)          | -                    |
| Net cash used in financing activities .....                                      | <u>(3,807,813)</u>   | <u>(34,383,055)</u>  | <u>(2,101,901)</u>   |
| Net (decrease) in cash and cash equivalents .....                                | (10,628,222)         | (16,606,028)         | (7,516,445)          |
| Cash and cash equivalents at beginning of year .....                             | <u>14,721,730</u>    | <u>31,327,758</u>    | <u>38,844,203</u>    |
| Cash and cash equivalents at end of year .....                                   | <u>\$ 4,093,508</u>  | <u>\$ 14,721,730</u> | <u>\$ 31,327,758</u> |
| <b>Supplemental disclosure of cash flow information:</b>                         |                      |                      |                      |
| Cash paid during the year for: Interest .....                                    | \$ -                 | \$ -                 | \$ -                 |
| Income taxes .....   | \$ -                 | \$ 3,756             | \$ -                 |

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

# Notes to Consolidated Financial Statements

## ORGANIZATION AND BASIS OF PRESENTATION

### Organization

Capital Southwest Corporation ("CSC" or the "Company") was 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 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." Capital Southwest Management Company ("CSMC"), a wholly-owned subsidiary of CSC, is the management company for CSC and CSVC. CSMC generally incurs all normal operating and administrative costs required for its day-to-day operations.

Our portfolio is a composite of companies in which we have majority 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. When appropriate, CSMC receives a monthly fixed fee for their management services provided by the portfolio companies.

### Basis of Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for investment companies. Under the investment company rules and regulations pursuant to Article 6 of Regulation S-X and the Audit and Accounting Guide for Investment Companies issued by the American Institute of Certified Public Accountants (the "AICPA Guide"), we are precluded from consolidating any entity other than another investment company. An exception to this general principle in the AICPA Guide occurs if the investment company has an investment in an operating company that provides services to the investment company. Therefore, our consolidated financial statements include our management company, CSMC.

We classify our portfolio investments in accordance with the requirements of the 1940 Act. Under the 1940 Act, "Control Investments" are defined as investments in which we own more than 25% of the voting securities or have rights to maintain greater than 50% of the board representation. Under the 1940 Act, "Affiliate Investments" are defined as investments in which we own between 5% and 25% of the voting securities. Under the 1940 Act, "Non-Control/Non-Affiliate Investments" are defined as investments that are neither Control Investments nor Affiliated Investments.



## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### 1. Significant Accounting Policies

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").

Fair Value Measurements. The Company adopted FASB ASC Topic 820 "*Fair Value Measurements*" on April 1, 2008. ASC Topic 820 (1) creates a single definition of fair value, (2) establishes a framework for measuring fair value, and (3) expands disclosure requirements about items measured at fair value. The Statement applies to both items recognized and reported at fair value in the financial statements and items disclosed at fair value in the notes to the financial statements. The Statement does not change existing accounting rules governing what can or what must be recognized and reported at fair value in the Company's financial statements, or disclosed at fair value in our notes to the financial statements. Additionally, Topic 820 does not eliminate practicability exceptions that exist in accounting pronouncements amended by this Statement when measuring fair value.

Prior to ASC Topic 820, certain measurements of fair value were based on the price that would be paid to acquire an asset, or received to assume a liability (an entry price). FASB Topic 820 clarifies the definition of fair value as the price that would be received from the sale of an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date (that is, an exit price). The exit price is based on the amount that the holder of the asset or liability would receive or need to pay in an actual transaction (or in a hypothetical transaction if an actual transaction does not exist) at the measurement date. In some circumstances, the entry and exit price may be the same; however, they are conceptually different.

Fair value is generally determined based on quoted market prices in the active markets for identical assets or liabilities. If quoted market

prices are not available, the Company uses valuation techniques that place greater reliance on observable inputs and less reliance on unobservable inputs. Due to the inherent uncertainty in the valuation process, the Company's estimate of fair value may differ materially from the values that would have been used had a ready market for the securities existed. In addition, changes in the market environment, portfolio company performance and other events may occur over the lives of the investments may cause the gains or losses ultimately realized on these investments to be materially different than the valuations currently assigned. We determine the fair value of each individual investment and record changes in fair value as unrealized appreciation or depreciation.

Pursuant to our internal valuation process, each portfolio company is valued once a quarter. In addition to our internal valuation process, our Board of Directors retains a nationally recognized firm to provide limited scope third party valuation services on certain portfolio investments. Our Board of Directors retained Duff & Phelps to provide limited scope third party valuation services on eight investments comprising 81.3% of our net asset value at March 31, 2010. Please refer to our Form 10-K for full disclosure of Duff & Phelps' services.

We believe our investments at March 31, 2010 and 2009 approximate fair value as of those dates based on the market in which we operate and other conditions in existence at those reporting periods.

Cash and Cash Equivalents. Cash and cash equivalents consist of highly liquid investments with an original maturity of three months or less at the date of purchase. Cash and cash equivalents are carried at cost, which approximates fair value.

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.

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.

Interest and Dividend Income. Interest and dividend income is recorded on an accrual basis to the extent amounts are expected to be collected. Dividend income is recorded at ex-dividend date for marketable securities and restricted securities. In accordance with our valuation policy, accrued interest and dividend income is evaluated periodically for collectability. When a debt or loan becomes 90 days or more past due, and if we otherwise do not expect the debtor to be able to service all of its debt or other obligations, we will generally establish a reserve against the interest or dividend income, thereby placing the loan or debt security's status on non-accrual basis and cease recognizing interest income on that loan or debt security until the borrower has demonstrated the ability and intent to pay contractual amounts due. If a loan or debt security's status significantly improves regarding ability to service the debt or other obligations, it will be restored to accrual basis.

Federal Income Taxes. CSC and CSVC have elected and intend to comply with the requirements of the Internal Revenue Code (IRC) necessary to qualify as regulated investment companies (RICs). By meeting these requirements, they will not be subject to corporate federal income taxes on ordinary income distributed to shareholders. In order to comply as a RIC, each company is required to timely distribute to its shareholders at least 90% of investment taxable income, as defined by the Code, each year. Taxable income generally differs from net income for financial reporting purposes due to temporary and

permanent differences in the recognition of income and expenses. Taxable income generally excludes net unrealized appreciation or depreciation, as investment gains or losses are not included in taxable income until they are realized. The Company's policy is to retain and pay the 35% corporate tax on realized long-term capital gains. For investment companies that qualify as RICs under the IRC, federal income taxes payable on security gains that the company elects to retain are accrued only on the last day of the tax year, December 31. Therefore, CSC and CSVC made no provision for federal income taxes on such gains and net investment income in their financial statements.

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

The Company accounts for interest and penalties as part of operating expenses. There were no interest or penalties incurred during the years ended March 31, 2010, 2009 and 2008.

Deferred Taxes. The Company sponsors a qualified defined benefit pension plan which covers its employees and employees of certain of its controlled affiliates. Deferred taxes related to the qualified defined benefit pension plan are recorded as incurred.

Stock-Based Compensation. At March 31, 2010, the Company has two stock-based incentive compensation plans. These plans encourage and enable the officers, employees, non-employee directors, and other key persons of the Company to acquire an interest in the Company. We account for our share-based compensation using the fair value method, as prescribed by ASC 718, *Compensation – Stock Compensation*. Accordingly, we recognize compensation cost over the straight-line method for all share-based payments granted on or after that date and for all awards granted to employees prior to April 1, 2006 that remain unvested on that date. The fair value of stock options are determined on the date of grant using the Black-Scholes pricing model and are expensed over the vesting period of the related stock options. See "Note 5, Stock-Based Compensation" for further discussion.

Defined Pension Benefits and Other Postretirement Plans. We record annual amounts relating to defined benefit pension plans based on calculations, which include various actuarial assumptions such as discount rates and assumed rates of return depending on the pension plan. Material changes in pension costs may occur in the future due to changes in the discount rate, changes in the expected long-term rate of return, changes in levels of contributions to the plans and other factors. The funded status is the difference between the fair value of plan assets and the benefit obligation. We recognize changes in the funded status of postretirement defined benefit plans in the Consolidated Statements of Assets and Liabilities in the year in which the changes occur and measure postretirement defined benefit plan assets and obligations as of the date of the employer's fiscal year-end. The Company presently uses March 31 as the measurement date for all of its postretirement defined benefit plans.

Concentration of Credit Risk. The Company places its idle cash with financial institutions in various money market accounts, which routinely exceed the Federal Deposit Insurance Corporation insured limit. As of March 31, 2010 and March 31, 2009, the Company's money market account balances exceeded the Federal Deposit Insurance Corporation's limits by \$3.1 million and \$13.8 million, respectively.

#### Recent Accounting Pronouncements

ASC No. 715-20-50-Pension Plan and Postretirement Benefit Plan Disclosure. In December 2008, the FASB issued ASC No. 715-20-50, "*Compensation – Retirement Benefits*" ("ASC 715-20-50"). ASC 715-20-50 requires enhanced disclosures about our plan assets for the defined benefit pension and other postretirement benefit plans. The enhanced disclosures required by this ASC are intended to provide users of financial statements with a greater understanding of: (1) how investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies; (2) the major categories of plan assets; (3) the inputs and valuation techniques used to measure the fair value of plan assets; (4) the effect of fair value measurements using significant unobservable inputs

(level 3) on changes in plan assets for the period; and (5) significant concentrations of risk within plan assets. This ASC became effective for us for our fiscal year ended March 31, 2010 and resulted in certain disclosures in Note 7.

ASC No. 855-10-Subsequent Events. In May 2009, the FASB issued ASC No. 855-10, "*Subsequent Events*" ("ASC 855-10"), which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC 855-10 became effective in the first quarter of fiscal March 31, 2010 and did not have a material impact on our consolidated financial statements. Additionally, in February 2010, the FASB issued Accounting Standards Update ("ASU") No. 2010-09, "*Amendments to Certain Recognition and Disclosure Requirements*" ("ASU 2010-09"), which became effective upon issuance and amended the guidance on subsequent events to remove the requirement for SEC filers to disclose the date through which an entity has evaluated subsequent events. We have evaluated certain events and transactions occurring after March 31, 2010 and, as disclosed in Note 10, we had one event that met the definition of a subsequent event for the period ended March 31, 2010.

Accounting Standard Codification. The Financial Accounting Standards Board's ("FASB") Accounting Standards Codification™ ("ASC") became effective on July 1, 2009. At that date, the ASC became FASB's officially recognized source of authoritative U.S. generally accepted accounting principles ("GAAP") applicable to all public and non-public non-governmental entities, superseding existing FASB, American Institute of Certified Public Accountants ("AICPA"), Emerging Issues Task Force ("EITF") and related literature. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The switch to ASC affects the way companies refer to U.S. GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure.

ASU No. 2009-05- Fair Value Measurements and Disclosures (Topic 820): Measuring Liabilities at Fair Value. In August 2009, the FASB issued Accounting Standards Update ("ASU") No. 2009-05, "*Measuring Liabilities at Fair Value*" ("ASU 2009-05"), which amends ASC 820-10. ASU 2009-05 provides clarification in circumstances when a quoted price in an active market for an identical liability is not available. In such instances, a reporting entity is required to measure fair value utilizing a valuation technique that uses (1) the quoted price of the identical liability when traded as an asset; (2) quoted prices for similar liabilities when traded as assets; or (3) another valuation technique that is consistent with the existing principles of ASC Topic 820, such as an income or market approach. ASU 2009-05 also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. Additionally, ASU 2009-5 clarifies that both a quoted price in an active market for an identical liability at the measurement date and the quoted price for an identical liability when traded as an asset in an active market when no adjustment to the quoted price of the asset are required are Level 1 fair value measurements. This ASU became effective for us for our fiscal year ended March 31, 2010 and did not have a material impact on our consolidated financial statements.

ASU No. 2009-12—Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset per Share (or Its Equivalent). In September 2009, the FASB issued ASU No. 2009-12 "*Investments in Certain Entities That Calculate Net Asset Per Share (or Its Equivalent)*," which provides further guidance for measuring the fair value of investments in certain entities that calculate net asset value per share or its equivalent; provided the investment does not have a readily determined fair value and the net asset value is calculated in a manner that is consistent with ASC Topic 946-Financial Services-Investment Companies, as of the reporting entities' measurement date, including the measurement of all or substantially all of the underlying investments of the investee in accordance with Topic 820. In such instances, a reporting entity is permitted to esti-

mate the fair value of an investment using the net asset value per share. This ASU became effective for us for our fiscal year ended March 31, 2010 and did not have a material impact on our consolidated financial statements.

ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. In January 2010, the FASB issued ASU No. 2010-06 "*Improving Disclosures about Fair Value Measurements*," which provides more robust disclosures about (1) the different classes of assets and liabilities measured at fair value, (2) the valuation techniques and inputs used, (3) the activity in Level 3 fair value measurements, and (4) the transfers between Levels 1, 2, and 3. ASU 2010-06 is effective for annual and interim periods beginning after December 15, 2009, except for the requirement to provide the Level 3 activity on a gross basis, which is effective for annual periods beginning after December 15, 2010 and for interim periods within those fiscal years. The Company will adopt ASU 2010-06 in the first quarter of 2010, except for the requirement to provide the Level 3 activity on a gross basis, which will be adopted after December 15, 2010. The Company does not expect the adoption of these disclosures to have a material impact on our consolidated financial position or results of operations.

## **2. Investments**

We fair value our investments in accordance with GAAP as determined in good faith by our Board of Directors. When available, we base the fair value of our investments on directly observable market prices or on market data derived for comparable assets. For all other investments, inputs used to measure fair value reflect management's best estimate of assumptions that would be used by market participants in pricing the investments in a hypothetical transaction.

The levels of fair value inputs used to measure our investments are characterized in accordance with the fair value hierarchy established by ASC Topic 820 "*Fair Value Measurements and Disclosures*." Where inputs for an asset or liability fall in more than one level in the fair val-

ue hierarchy, the investment is classified in its entirety based on the lowest level input that is significant to that investment's fair value measurement. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical investments (Level 1) and lowest priority to unobservable inputs (Level 3). We use judgment and consider factors specific to the investment in determining the significance of an input to a fair value measurement.

The three levels of the fair value hierarchy and investments that fall into each of the levels are described below:

- *Level 1:* Investments whose values are based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. We use Level 1 inputs for publicly traded unrestricted securities for which we do not have a controlling interest. Such investments are valued at the closing price for listed securities and at the lower of the closing bid price or the closing sale price for securities traded on the NASDAQ on the valuation date.
- *Level 2:* Investments whose values are based on data other than the quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. We did not value any of our investments using level 2 inputs as of March 31, 2010.
- *Level 3:* Investments whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing the investment. We use Level 3 inputs for measuring the fair value of substantially all of our investments. See "Notes to Schedule of Investments" (c) on page 17 for the investment policy used to determine the fair value of these investments.

As required by ASC 820, when the inputs used to measure a fair value fall within different levels of the hierarchy, the level within the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. For example, a level 3 fair value measurement may include inputs that are observable (Levels 1 and 2) and unobservable (3). We conduct reviews of fair value hierarchy on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification of certain assets.

The following fair value hierarchy tables set forth our investment portfolio by level as of March 31, 2010 and 2009 (in millions):

|                       |                | Fair Value Measurements<br>at 3/31/2010 Using              |                               |                                       |
|-----------------------|----------------|--|-------------------------------|---------------------------------------|
|                       |                | Significant  |                               |                                       |
|                       |                | Quoted Prices in<br>Active Markets<br>for Identical Assets | Other<br>Observable<br>Inputs | Significant<br>Unobservable<br>Inputs |
| <u>Asset Category</u> | <u>Total</u>   | <u>Level 1</u>   | <u>Level 2</u>                | <u>Level 3</u>                        |
| Debt                  | \$ 14.6        | \$ -   | \$ -                          | \$ 14.6                               |
| Partnership Interests | 8.6            | -  | -                             | 8.6                                   |
| Preferred Equity      | 35.3           | -  | -                             | 35.3                                  |
| Common Equity         | <u>419.4</u>   | <u>21.0</u>  | -                             | <u>398.4</u>                          |
| Total Investments     | <u>\$477.9</u> | <u>\$21.0</u>  | <u>\$ -</u>                   | <u>\$456.9</u>                        |

  

|                       |                | Fair Value Measurements<br>at 3/31/2009 Using              |                               |                                       |
|-----------------------|----------------|--|-------------------------------|---------------------------------------|
|                       |                | Significant  |                               |                                       |
|                       |                | Quoted Prices in<br>Active Markets<br>for Identical Assets | Other<br>Observable<br>Inputs | Significant<br>Unobservable<br>Inputs |
| <u>Asset Category</u> | <u>Total</u>   | <u>Level 1</u>   | <u>Level 2</u>                | <u>Level 3</u>                        |
| Debt                  | \$ 8.3         | \$ -   | \$ -                          | \$ 8.3                                |
| Partnership Interests | 6.8            | -  | -                             | 6.8                                   |
| Preferred Equity      | 16.4           | -  | -                             | 16.4                                  |
| Common Equity         | <u>365.2</u>   | <u>13.8</u>  | -                             | <u>351.4</u>                          |
| Total Investments     | <u>\$396.7</u> | <u>\$13.8</u>  | <u>\$ -</u>                   | <u>\$382.9</u>                        |

The following tables set forth a summary of changes in the fair value of investment assets and liabilities measured using Level 3 inputs during the years ended March 31, 2010 (in millions):

| <u>Asset Category</u> | Fair Value<br><u>3/31/09</u> | Net   |   |   | Fair Value<br><u>3/31/10</u> |
|-----------------------|------------------------------|---|---|---|------------------------------|
|                       |                              | Unrealized<br>Appreciation<br><u>(Depreciation)</u> | Net New<br>Investments<br><u>(Divestitures)</u> | Conversion of<br>Security from<br><u>Debt to Equity</u> |                              |
| Debt                  | \$ 8.3                       | \$ 4.9  | 2.7   | \$ (1.3)  | \$ 14.6                      |
| Partnership           |                              |   |   |   |                              |
| Interests             | 6.8                          | (0.2)   | 2.1   | -   | 8.6                          |
| Preferred             |                              |   |   |   |                              |
| Equity                | 16.4                         | 9.4   | 8.2   | 1.3   | 35.3                         |
| Common                |                              |   |   |   |                              |
| Equity                | <u>351.4</u>                 | <u>49.3</u>   | <u>(2.3)</u>                                    | <u>---</u>  | <u>398.4</u>                 |
| Total                 |                              |   |   |   |                              |
| Investments           | <u>\$382.9</u>               | <u>\$ 63.4</u>                                      | <u>\$10.7</u>                                   | <u>---</u>  | <u>\$ 456.9</u>              |

| <u>Asset Category</u> | Fair Value<br><u>3/31/08</u> | Net   |   |   | Fair Value<br><u>3/31/09</u> |
|-----------------------|------------------------------|---|---|---|------------------------------|
|                       |                              | Unrealized<br>Appreciation<br><u>(Depreciation)</u> | Net New<br>Investments<br><u>(Divestitures)</u> | Conversion of<br>Security from<br><u>Debt to Equity</u> |                              |
| Debt                  | \$ 9.0                       | \$ (5.0)  | \$ 4.3  | \$ -  | \$ 8.3                       |
| Partnership           |                              |   |   |   |                              |
| Interests             | 5.3                          | (0.9)   | 2.3   | -   | 6.8                          |
| Preferred             |                              |   |   |   |                              |
| Equity                | 21.8                         | (11.5)  | 6.1   | -   | 16.4                         |
| Common                |                              |   |   |   |                              |
| Equity                | 458.3                        | (107.2)   | 0.3   | -   | 351.4                        |
| Equity                |                              |   |   |   |                              |
| Warrants              | <u>0.4</u>                   | <u>(0.4)</u>  | <u>---</u>                                      | <u>---</u>  | <u>---</u>                   |
| Total                 |                              |   |   |   |                              |
| Investments           | <u>\$ 494.8</u>              | <u>\$ (124.9)</u>                                   | <u>\$13.0</u>                                   | <u>\$-</u>  | <u>\$ 382.9</u>              |

The amount of total gains for the years ended March 31, 2010 and 2009 included in change in net assets attributable to the change in net unrealized appreciation (depreciation) relating to assets (level 3) still

held at reporting date was \$63,933,254 and \$(124,976,775), respectively.

### 3. Income Taxes

We operate to qualify as a RIC under Subchapter M of the IRC. In order to qualify as a RIC, we must annually distribute at least 90% of our taxable ordinary income, based on our tax year, to our shareholders in a timely manner. Ordinary income includes net short-term capital gains but excludes net long-term capital gains. A RIC is not subject to federal income tax on the portion of its ordinary income and long-term capital gains that are distributed to its shareholders, including "deemed distributions" discussed below. As permitted by the IRC, a RIC can designate dividends paid in the subsequent tax year as dividends of current year ordinary income and net long-term gains if those dividends are both declared by the extended due date of the RIC's federal income tax return and paid to shareholders by the last day of the subsequent tax year. We have a calendar tax year end of December 31.

We have distributed or intend to distribute sufficient dividends to eliminate taxable income for our completed tax years. If we fail to satisfy the 90% distribution requirement or otherwise fail to qualify as a RIC in any tax year, we would be subject to tax in such year on all of our taxable income, regardless of whether we made any distributions to our shareholders. For the tax years ended December 31, 2009 and 2008, we declared and paid ordinary dividends in the amount of \$2,993,310 and \$12,256,745, respectively.

Additionally, we are also subject to a nondeductible federal excise tax of 4% if we do not distribute at least 98% of our investment company ordinary taxable income before the end of our tax year. For the tax year ended December 31, 2009 we distributed 100% of our investment company ordinary taxable income. As a result we have made no provision for income taxes on ordinary taxable income for the tax year ended December 31, 2009.

A RIC may elect to retain its long-term capital gains by designating them as a “deemed distribution” to its shareholders and paying a federal tax of 35% on the long-term capital gains for the benefit of its shareholders. Shareholders would then report their share of the retained capital gains on their income tax returns as if it had been received and report a tax credit for the tax paid on their behalf by the RIC. Shareholders then add the amount of the “deemed distribution,” net of such tax, to the basis of their shares. For the tax year ended December 31, 2009, we have estimated net long-term capital gains of \$2,327,150 for tax purposes and \$1,682,616 for book purposes, which we elected to retain and treat as deemed distributions to our shareholders. Likewise, for the tax year ended December 31, 2008, we had net long-term capital gains of \$14,922,751 for tax purposes and \$15,936,644 for book purposes, which we elected to retain and treat as deemed distributions to our shareholders. As a result of our election to retain long-term capital gains, we incurred federal taxes on behalf of our shareholders in the amount of \$814,503 and \$5,222,964 for the tax years ended December 31, 2009 and 2008, respectively. As of December 31, 2009, we did not have any undistributed long-term capital gains since they are being treated as a “deemed distribution.”

For the tax years ended December 31, 2009 and 2008, CSC and CSVC qualified to be taxed as RICs. We intend to meet the applicable qualifications to be taxed as a RIC in future years. Management feels it is probable that we will maintain our RIC status for a period longer than one year. However, either company’s ability to meet certain portfolio diversification requirements of RICs in future years may not be controllable by such company.

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

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

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

The following table sets forth a summary of our net realized gains on transactions by category:

| Net Realized Gains On Transaction In<br><u>Investment Securities of</u> | <u>For the Tax Year Ended December 31,</u> |                     |
|---|--|---------------------|
|   | <u>2009</u>                                | <u>2008</u>         |
| Unaffiliated issuers  | \$206,5212                                 | \$15,936,644        |
| Affiliated issuers  | 1,433,472                                  | -                   |
| Investments other than securities                                       | -  | -                   |
| Net realized gain on investments before taxes                           | \$1,639,994                                | \$15,936,644        |
| Income tax expense  | <u>814,503</u>                             | <u>5,222,964</u>    |
| Net realized gain on investments  | <u>\$ 825,491</u>                          | <u>\$10,713,680</u> |
| Net realized gains (for tax purposes)                                   | <u>\$2,327,150</u>                         | <u>\$14,922,751</u> |

As a result of our election to retain long-term capital gains, we incurred federal taxes on behalf of our shareholders in the amounts listed in the table above. As of March 31, 2010, we did not have undistributed long-term capital gains (losses) since they are being treated as a “deemed distribution,” while we reported undistributed long-term capital gains of \$42,622 as of March 31, 2009.

#### 5. Employee Stock Option Plan

On July 20, 2009, shareholders approved our 2009 Stock Incentive Plan (the “2009 Plan”), which provides for the granting of stock options to employees and officers of the Company and authorizes the

issuance of common stock upon exercise of such options for up to 140,000 shares. All options are granted at or above market price, generally expire up to ten years from the date of grant, and are generally exercisable on or after the first anniversary of the date of grant in five annual installments. Options to purchase 38,750 shares at a price of \$76.74 (market price at the time of the grant) were granted on October 19, 2009. Additionally, options to purchase 20,000 shares at a price of \$95.79 (market price at time of the grant) were granted on March 22, 2010. All 58,750 shares remain outstanding, thus leaving 81,250 options available for grant under the plan.

The Company previously granted stock options under our 1999 Stock Option Plan (the "1999 Plan"), as approved by shareholders on July 19, 1999. The 1999 Plan expired on April 19, 2009. Options previously granted under the 1999 Plan and outstanding on July 20, 2009 continue to be governed by the provisions of the 1999 Plan. All options granted under the 1999 Plan were granted at or above market price, generally expire up to 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.

We recognize compensation cost over the straight-line method for all share-based payments granted and for all awards granted to employees prior to April 1, 2006 that remain unvested. The fair value of the stock options are determined on the date of grant using the "Black-Scholes Pricing Model" and are expensed over the vesting period of the related stock options. Accordingly, for the years ended March 31, 2010, 2009 and 2008, we recognized compensation expense of \$675,210, \$503,645, and \$263,664 respectively.

As of March 31, 2010, the total remaining unrecognized compensation cost related to non-vested stock options was \$3,332,391, which will be amortized over the weighted-average service period of approximately 4.1 years.

The following table summarizes the 2009 Plan and the 1999 Plan price per option at grant date using the Black-Scholes Pricing Model:

| Date of Issuance | Weighted Average Fair Value | Black-Scholes Pricing Model Assumptions |                         |                     |                          |
|------------------|-----------------------------|---|-------------------------|---------------------|--------------------------|
|                  |                             | Expected Dividend Yield                 | Risk-Free Interest Rate | Expected Volatility | Expected Life (in years) |
| <u>2009 Plan</u> |                             |   |                         |                     |                          |
| March 22, 2010   | \$32.56                     | 0.84%                                   | 2.43%                   | 37.8%               | 5                        |
| October 19, 2009 | \$25.36                     | 1.04%                                   | 2.36%                   | 37.6%               | 5                        |
| <u>1999 Plan</u> |                             |   |                         |                     |                          |
| July 30, 2008    | \$29.93                     | 0.62%                                   | 3.36%                   | 20.2%               | 5                        |
| July 21, 2008    | \$27.35                     | 0.67%                                   | 3.41%                   | 20.2%               | 5                        |
| July 16, 2007    | \$41.78                     | 0.39%                                   | 4.95%                   | 19.9%               | 5                        |
| July 17, 2006    | \$33.05                     | 0.61%                                   | 5.04%                   | 21.2%               | 7                        |
| May 15, 2006     | \$31.28                     | 0.64%                                   | 5.08%                   | 21.1%               | 7                        |

The following summarizes activity in the stock option plans for the years ended March 31, 2010, 2009 and 2008:

|                                    | Number of shares | Weighted Average Exercise Price |
|------------------------------------|------------------|---------------------------------|
| <u>2009 Plan</u>                   |                  |                                 |
| Balance at March 31, 2009          | -                | \$ -                            |
| Granted                            | 58,750           | 83.23                           |
| Exercised                          | -                | -                               |
| Canceled                           | -                | -                               |
| Balance at March 31, 2010          | 58,750           | \$83.23                         |
| <u>1999 Plan</u>                   |                  |                                 |
| Balance at March 31, 2008          | 70,400           | \$110.00                        |
| Granted                            | 37,500           | 123.72                          |
| Exercised                          | -                | -                               |
| Canceled                           | -                | -                               |
| Balance at March 31, 2009          | 107,900          | \$114.78                        |
| Granted                            | -                | -                               |
| Exercised                          | -                | -                               |
| Canceled                           | -                | -                               |
| Balance at March 31, 2010          | <u>107,900</u>   | <u>\$114.78</u>                 |
| Combined Balance at March 31, 2010 | <u>166,650</u>   | <u>\$103.65</u>                 |



|                | Weighted Average Aggregate Intrinsic |              |
|----------------|--------------------------------------|--------------|
|                | <u>Remaining Contractual Term</u>    | <u>Value</u> |
| March 31, 2010 |                                      |              |
| Outstanding    | 4.1 years                            | \$4,889,443  |
| Exercisable    | 3.4 years                            | \$1,158,499  |

At March 31, 2010, the range of exercise prices and weighted-average remaining contractual life of outstanding options was \$65.00 to \$152.98 and 4.1 years, respectively. There were no options exercised during the years ended March 31, 2010 and March 31, 2009. The total intrinsic value of options exercised during the years ended March 31, 2008 was \$75,129. The exercise prices ranged from \$65.00 to \$93.49 per share for the each of the years ended March 31, 2008. New shares were issued for \$231,390 cash received from option exercises for the years ended March 31, 2008.

At March 31, 2010, 2009 and 2008, the number of options exercisable was 38,960, 21,445 and 9,930, respectively and the weighted-average exercise price of those options was \$107.94, \$97.00 and \$79.01, respectively.

## 6. Employee Stock Ownership Plan

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

Effective April 1, 2007, the vesting period for the ESOP is three years. During the 3 years ended March 31, 2010, the Company made contributions to the ESOP, which were charged against net investment income, of \$144,436 in 2010, \$0 in 2009 and \$94,210 in 2008.

## 7. Retirement Plans

CSC sponsors a qualified defined benefit pension plan which covers its employees and employees of certain of its controlled affiliates. The

following information about the plan represents amounts and information related to CSC's participation in the plan and is presented as though CSC sponsored a single-employer plan. Benefits are based on years of service and an average of the highest five consecutive years of compensation during the last 10 years of employment. The funding policy of the plan is to contribute annual amounts that are currently deductible for tax reporting purposes. No contribution was made to the plan during the three years ended March 31, 2010.

Additionally, CSC 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 tables set forth the qualified plan's net pension benefit, benefit obligation, fair value of plan assets, and amounts recognized in CSC's consolidated statements of assets and liabilities at March 31, 2010, 2009 and 2008; as well as amounts recognized in CSC's consolidated statements of assets and liabilities at March 31, 2010 and 2009:

|   | <u>Years Ended March 31</u> |                    |                    |
|---|-----------------------------|--------------------|--------------------|
|   | <u>2010</u>                 | <u>2009</u>        | <u>2008</u>        |
| <b>Net pension benefit</b>                    |                             |                    |                    |
| Service cost-benefits earned during           |                             |                    |                    |
| the year.....                                 | \$116,746                   | \$67,340           | \$67,514           |
| Interest cost on projected benefit obligation | 191,936                     | 290,310            | 222,895            |
| Expected return on assets.....                | (735,366)                   | (732,837)          | (673,366)          |
| Net amortization.....                         | <u>9,006</u>                | <u>3,725</u>       | <u>3,725</u>       |
| Net pension benefit from qualified plan...    | <u>\$(417,678)</u>          | <u>\$(371,462)</u> | <u>\$(379,232)</u> |
| <b>Change in benefit obligation</b>           |                             |                    |                    |
| Benefit obligation at beginning               |                             |                    |                    |
| of year.....                                  | \$2,914,813                 | \$3,699,285        | \$3,965,100        |
| Service cost .....                            | 116,746                     | 67,340             | 67,514             |
| Interest cost.....                            | 191,936                     | 290,310            | 222,895            |
| Actuarial gain (loss) .....                   | 295,379                     | (916,874)          | (160,840)          |
| Benefits paid .....                           | (68,131)                    | (259,810)          | (395,384)          |
| Plan change .....                             | -                           | 34,262             | -                  |
| Benefit obligation at end of year.....        | <u>\$3,450,443</u>          | <u>\$2,914,513</u> | <u>\$3,699,285</u> |

|   | Years Ended March 31 |                     |                     |
|---|----------------------|---------------------|---------------------|
|   | 2010                 | 2009                | 2008                |
| <b>Change in plan assets</b>                  |                      |                     |                     |
| Fair value of plan assets at beginning        |                      |                     |                     |
| of year.....                                  | \$8,383,373          | \$11,120,337        | \$12,973,292        |
| Actual return on plan assets.....             | 2,204,158            | (2,477,154)         | (1,457,571)         |
| Benefits paid .....                           | (68,131)             | (259,810)           | (395,384)           |
| Fair value of plan assets at end of year..... | <u>\$10,519,400</u>  | <u>\$ 8,383,373</u> | <u>\$11,120,337</u> |

|   | March 31             |                      |
|---|----------------------|----------------------|
|   | 2010                 | 2009                 |
| <b>Funded status and amounts recognized in our consolidated statements of assets and liabilities</b>                      |                      |                      |
| Actuarial present value of benefit obligations:   |                      |                      |
| Accumulated benefit obligation.....   | <u>\$(3,076,629)</u> | <u>\$(2,630,743)</u> |
| Projected benefit obligation for service rendered to date.....  | <u>\$(3,450,443)</u> | <u>\$(2,914,513)</u> |
| Plan assets at fair value* .....  | <u>10,519,400</u>    | <u>8,383,373</u>     |
| Funded status .....   | 7,068,957            | 5,468,860            |
| Unrecognized net (gain) loss from past experience different from that assumed and effects of changes in assumptions ..... | 1,328,748            | 2,502,161            |
| Unrecognized prior service costs .....  | 150,710              | 159,716              |
| Additional asset, FAS 158 .....   | <u>(1,479,458)</u>   | <u>(2,661,877)</u>   |
| Prepaid pension cost included in pension assets.....  | <u>\$ 7,068,957</u>  | <u>\$ 5,468,860</u>  |

\*Primarily equities and bonds including approximately 25,000 shares of CSC Common Stock.

The following tables set forth the retirement restoration plan's net pension benefit and benefit obligation amounts at March 31, 2010, 2009 and 2008; as well as amounts recognized in CSC's consolidated statements of assets and liabilities at March 31, 2010, 2009:

|   | Years Ended March 31 |                  |                 |
|---|----------------------|------------------|-----------------|
|   | 2010                 | 2009             | 2008            |
| <b>Net pension benefit</b>                          |                      |                  |                 |
| Service cost-benefits earned during the year.....   | \$26,847             | \$10,986         | \$10,483        |
| Interest cost on projected benefit obligation ..... | 60,334               | 104,777          | 57,588          |
| Net amortization.....                               | <u>(38,605)</u>      | <u>2,470</u>     | <u>(16,186)</u> |
| Net pension benefit from qualified plan ..          | <u>\$48,576</u>      | <u>\$118,233</u> | <u>\$51,885</u> |

|  | Years Ended March 31 |                  |                  |
|--|----------------------|------------------|------------------|
|  | 2010                 | 2009             | 2008             |
| <b>Change in benefit obligation</b>    |                      |                  |                  |
| Benefit obligation at beginning        |                      |                  |                  |
| of year.....                           | \$934,427            | \$942,122        | \$1,178,891      |
| Service cost .....                     | 26,847               | 10,986           | 10,483           |
| Interest cost.....                     | 60,334               | 104,777          | 57,588           |
| Actuarial gain (loss) .....            | 61,332               | (74,613)         | (169,072)        |
| Benefits paid .....                    | -                    | (68,934)         | (135,768)        |
| Plan change .....                      | -                    | <u>20,089</u>    | -                |
| Benefit obligation at end of year..... | <u>\$1,082,941</u>   | <u>\$934,427</u> | <u>\$942,122</u> |

|   | March 31             |                    |
|---|----------------------|--------------------|
|   | 2010                 | 2009               |
| <b>Amounts recognized in our consolidated statements of assets and liabilities</b>  |                      |                    |
| Projected benefit obligation.....   | \$(1,082,941)        | \$(934,427)        |
| Unrecognized net (gain) loss from past experience different from that assumed and effects of changes in assumptions ..... | (347,741)            | \$(431,432)        |
| Unrecognized prior service costs .....  | (171,034)            | (187,280)          |
| Additional asset, FAS 158.....  | <u>518,775</u>       | <u>618,712</u>     |
| Prepaid pension cost included in pension liabilities .....  | <u>\$(1,082,941)</u> | <u>\$(934,427)</u> |

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

|                                     | Years Ended March 31 |      |       |
|-------------------------------------|----------------------|------|-------|
|                                     | 2010                 | 2009 | 2008  |
| Discount rate .....                 | 6.00%                | 6.5% | 6.25% |
| 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 |       |      |
|-------------------------------------|----------------------|-------|------|
|                                     | 2010                 | 2009  | 2008 |
| Discount rate .....                 | 6.5%                 | 6.25% | 6.0% |
| Expected return on plan assets..... | 6.5%                 | 6.5%  | 6.5% |
| Rate of compensation increases..... | 5.0%                 | 5.0%  | 5.0% |

Following are the expected benefit payments for the next five years and in the aggregate for the years 2016-2020:

| (In Thousands)   | Years Ended March 31 |       |       |       |       | 2016-   |
|------------------|----------------------|-------|-------|-------|-------|---------|
|                  | 2011                 | 2012  | 2013  | 2014  | 2015  | 2020    |
| Qualified Plan   | \$60                 | \$207 | \$199 | \$191 | \$184 | \$1,034 |
| Restoration Plan | \$18                 | \$93  | \$89  | \$85  | \$82  | \$367   |

We use the "Citigroup Pension Liability Index" to determine the discount rate. 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.

### Plan Assets

CSC'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 18% of the assets are selected and managed by the trustee and the remainder of the assets is managed by the committee, invested mostly in equity securities, including CSC stock. The plan assets are invested using a total return approach whereby a mix of equity securities, debt securities and other investments are used to preserve asset values, diversify risk and achieve our targeted investment return benchmark. Investment performance and asset allocation are measured and monitored on an ongoing basis.

Plan assets are managed in a balanced portfolio comprised of two major components: an equity portion and a fixed income portion. The expected role of Plan equity investments is to maximize the long-term real growth of Fund assets, while the role of fixed income investments is to generate current income, provide for more stable periodic returns and provide some protection against prolonged decline in the market value of Fund equity investments.

The current target allocations for plan assets are 60-80% equity, 15-40% for fixed income, and 0-15% for cash and cash equivalents. Equity investments include U.S. and foreign equities, as well as publicly traded and non-publicly traded mutual funds. Fixed income securities include long-duration government obligations, government agency obligations and corporate obligations.

CSC's pension plan asset allocations are as follows:

| Asset Category                  | Percentage of plan assets<br>at March 31 |               |
|---------------------------------|--|---------------|
|                                 | 2010                                     | 2009          |
| Equity securities .....         | 74.2%                                    | 67.7%         |
| Fixed income securities .....   | 16.5%                                    | 19.2%         |
| Cash and cash equivalents ..... | 9.3%                                     | 13.1%         |
|                                 | <u>100.0%</u>                            | <u>100.0%</u> |

The following fair value hierarchy table sets forth our pension plan investment portfolio by level as of March 31, 2010 (in millions):

| Asset Category              | Total         | Fair Value Measurements<br>at Reporting Date Using                  |  |                                       |
|-----------------------------|---------------|---|--|---------------------------------------|
|                             |               | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets | Significant<br>Other<br>Observable<br>Inputs | Significant<br>Unobservable<br>Inputs |
|                             |               | Level 1   | Level 2                                      | Level 3                               |
| Equity securities (a)       | \$ 7.8        | \$ 6.4  | \$ 1.4                                       | \$ -                                  |
| Fixed income securities (b) | 1.7           | -   | 1.7  | -                                     |
| Cash and cash equivalents   | 1.0           | 1.0   | -  | -                                     |
| Total                       | <u>\$10.5</u> | <u>\$7.4</u>  | <u>\$ 3.1</u>                                | <u>\$ -</u>                           |

There were no plan assets valued using significant unobservable inputs (level 3) as of March 31, 2010.

(a) This category includes investment in equity securities of large, medium and small companies and equity investments in foreign companies. Mutual funds included in this category are valued using the net asset value per unit as of the valuation date. These investments include shares of our common stock. At March 31, 2010 and 2009, Capital Southwest Corporation common stock represented 21.9% and 22.7%, respectively, of the plan assets.

b) This category includes investments in investment grade fixed income instruments, primarily U.S. government obligations.

## 8. Commitments

CSC has agreed, subject to certain conditions, to invest up to \$5,518,463 in seven portfolio companies.

The Company leases office space under an operating lease which requires base annual rentals of approximately \$101,000 through April, 2013. For the three years ended March 31, total rental expense charged to investment income was \$92,075 in 2010, \$84,117 in 2009 and \$80,569 in 2008.

## 9. Sources of Income

Income was derived from the following sources:

| Years Ended<br>March 31<br>2010                   | Investment Income  |                    |                    | Realized Gain<br>(Loss) on<br>Investments<br>Before Income<br>Taxes |
|---|--------------------|--------------------|--------------------|---|
|   | Interest           | Dividends          | Other<br>Income    |   |
| Companies more than<br>25% owned .....            | \$14,473           | \$3,359,942        | \$1,055,900        | \$1,433,472   |
| Companies 5% to 25%<br>owned .....                | 1,500              | 326,940            | 13,000             | -   |
| Companies less than<br>5% owned .....             | 1,009,276          | 101,798            | 206,522            | 206,522   |
| Other sources, including<br>temporary investments | 19,618             | -                  | 337                | -   |
|   | <u>\$1,044,867</u> | <u>\$3,788,680</u> | <u>\$1,275,759</u> | <u>\$1,639,994</u>  |

| Years Ended<br>March 31<br>2009                            | Investment Income  |                     |                    | Realized Gain<br>(Loss) on<br>Investments<br>Before Income<br>Taxes |
|--|--------------------|---------------------|--------------------|---|
|  | Interest           | Dividends           | Other<br>Income    |   |
| Companies more than<br>25% owned .....                     | \$ -               | \$10,946,581        | \$1,055,000        | \$ -  |
| Companies 5% to 25%<br>owned .....                         | 249,417            | 326,940             | 20,750             | -   |
| Companies less than<br>5% owned .....                      | 743,937            | 260,357             | 9                  | 15,979,266  |
| Other sources,<br>including temporary<br>investments ..... | 381,861            | -                   | 280                | -   |
|  | <u>\$1,375,215</u> | <u>\$11,533,878</u> | <u>\$1,076,039</u> | <u>\$15,979,266</u>   |

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

## 10. Subsequent Events

On April 29, 2010 Capital Southwest Corporation, Lifemark Group, a wholly owned investment of the Company, NorthStar Memorial Group, LLC and NorthStar Cemetery Services of California, LLC, a wholly owned subsidiary of NorthStar ("Purchaser"), entered into a Stock Purchase Agreement, providing for the sale of all issued and outstanding shares of capital stock of Lifemark Group to Purchaser.

Consideration for the sale will be cash in the aggregate of \$84,750,000. Pursuant to terms of the Stock Purchase Agreement, the purchase price will be reduced by the amount of the Lifemark's outstanding indebtedness. The purchase price will also be subject to an adjustment based on certain estimated costs or expenses that have been or will be incurred by the Company or its subsidiary associated with, arising out of or relating to the distribution of certain assets. In addition, the purchase is subject to customary adjustments based on the amount of Seller's net assets at the time the sale is completed.

The Stock Purchase Agreement contains representations and warranties, covenants, indemnification provisions and closing conditions that are customary for transactions of this type, including covenants by the Seller related to the conduct of business between the signing of the Stock Purchase Agreement and completion of the sale. Completion of the transaction is subject to customary closing conditions for transactions of this type, including approval from the State of California.

## Schedule of Investments in and Advances to Affiliates

| Portfolio Company/Type of Investment (1)   | Amount of<br>Interest, Fees<br>or Dividends<br>Credited in<br>Income (2) | Fair Value at<br>March 31,<br>2009 | Gross<br>Additions (3) | Gross<br>Reductions (4) | Fair Value at<br>March 31,<br>2010 |
|--|--|------------------------------------|------------------------|-------------------------|------------------------------------|
| <b>Control Investments</b>   |  |                                    |                        |                         |                                    |
| THE RECTORSEAL CORPORATION<br>27,907 shares of common stock.....   | \$ 2,477,870   | \$ 107,200,000                     | \$ 13,000,000          | \$ -                    | \$ 120,200,000                     |
| LIFEMARK GROUP<br>1,449,026 shares of common stock.....  | 500,000  | 71,000,000                         | -                      | -                       | 71,000,000                         |
| THE WHITMORE MANUFACTURING COMPANY<br>80 shares of common stock .....  | 649,467  | 36,000,000                         | 11,500,000             | -                       | 47,500,000                         |
| ALAMO GROUP INC.<br>2,830,300 shares of common stock.....  | 717,872  | 22,642,400                         | 19,812,100             | -                       | 42,454,500                         |
| HEELYS, INC.<br>9,317,310 shares of common stock ...   | -  | 13,975,965                         | 5,869,905              | -                       | 19,845,870                         |
| MEDIA RECOVERY, INC<br>800,000 shares Series A Convertible Preferred Stock, convertible into<br>800,000 shares of common stock at \$1.00.....    | -  | 2,500,000                          | -                      | (300,000)               | 2,200,000                          |
| 4,000,002 shares common stock .....  | -  | 12,300,000                         | -                      | (1,100,000)             | 11,200,000                         |
| PALM HARBOR HOMES, INC.<br>7,855,121 shares common stock .....   | 46,972   | 9,818,902                          | 3,000,000              | (5,984,947)             | 6,833,955                          |
| BALCO, INC.<br>445,000 shares common stock and 60,920 shares Class B non-voting<br>common stock  | -  | 6,600,000                          | 1,400,000              | -                       | 8,000,000                          |
| DENNIS TOOL COMPANY<br>20,725 shares 5% Convertible Preferred Stock, convertible into 20,725<br>shares of common stock at \$48.25 per share..... | -  | 999,981                            | -                      | (999,981)               | -                                  |
| 140,137 shares common stock .....  | 33,333   | 2,868,000                          | -                      | (2,868,000)             | -                                  |
| DISCOVERY ALLIANCE, LLC<br>90.0% limited liability company .....   | -  | 450,000                            | 300,000                | -                       | 750,000                            |
| HUMAC COMPANY<br>1,041,000 shares of common stock.....   | 4,800  | 133,000                            | 30,000                 | -                       | 163,000                            |
| <b>Total Control Investments</b>   | <u>\$ 4,430,314</u>  | <u>\$ 286,488,248</u>              | <u>\$ 54,912,005</u>   | <u>\$ (11,252,928)</u>  | <u>\$ 330,147,325</u>              |
| <b>Affiliated Investments</b>  |  |                                    |                        |                         |                                    |
| ENCORE WIRE CORPORATION<br>4,086,750 shares of common stock.....   | \$339,940  | \$65,388,000                       | \$2,043,375            | \$ -                    | \$67,431,375                       |

## Schedule of Investments in and Advances to Affiliates

| <u>Portfolio Company/Type of Investment (1)</u>  | <u>Amount of<br/>Interest, Fees<br/>or Dividends<br/>Credited in<br/>Income (2)</u> | <u>Fair Value at<br/>March 31,<br/>2009</u> | <u>Gross<br/>Additions (3)</u> | <u>Gross<br/>Reductions (4)</u> | <u>Fair Value at<br/>March 31,<br/>2010</u> |
|--|---|---|--------------------------------|---------------------------------|---|
| <b>Affiliated Investments</b> (continued)  |   |   |                                |                                 |   |
| CMI HOLDING COMPANY, INC.  |   |   |                                |                                 |   |
| 10% Convertible Promissory Note, due 2009 .....  | \$1,500   | \$1,000,000                                 | \$ -                           | \$(1,000,000)                   | \$ -  |
| 10% Convertible Promissory Note, due 2013 .....  | -   | -   | 1,300,000                      | -                               | 1,300,000                                   |
| 1,631,516 shares Series C-1 Convertible Preferred Stock, convertible into<br>1,631,516 shares of common stock at \$2.15 per share .. | -   | 2   | 2,857,759                      | -                               | 2,857,761                                   |
| 2,327,658 shares Series C-1 Convertible Preferred Stock, convertible into<br>2,327,658 shares of common stock at \$1.72 per share .. | -   | -   | -                              | -                               | -   |
| Warrants to purchase 109,012 shares of common stock at \$1.72 per<br>share, expiring 2012  | -   | -   | -                              | -                               | -   |
| Warrants to purchase 636,151 shares of Series A-1 Convertible Preferred<br>Stock at \$1.72 per share expiring 2017 and 2019          | -   | -   | -                              | -                               | -   |
| Warrants to purchase 90,698 shares of Series D or D-1 Convertible Pre-<br>ferred Stock at \$1.72 per share expiring 2017             | -   | -   | -                              | -                               | -   |
| PALLETONE, INC.  |   |   |                                |                                 |   |
| 12.3% Senior Subordinated Notes, \$2,000,000 due 2012  | -   | 2   | 1,999,998                      | -                               | 2,000,000                                   |
| 150,000 shares of common stock   | -   | 2   | -                              | -                               | 2   |
| Warrant to purchase 15,294 shares of common stock at \$1.00 per share,<br>expiring 2011  | -   | -   | -                              | -                               | -   |
| BOXX TECHNOLOGIES, INC.  |   |   |                                |                                 |   |
| 3,125,354 shares Series B Convertible Preferred Stock, convertible<br>into 3,125,354 shares of common stock at \$0.50 per share      | -   | 2   | -                              | -                               | 2   |
| WELLOGIX, INC.   |   |   |                                |                                 |   |
| 4,788,371 shares Series A-1 Convertible Preferred Stock, convertible<br>into 4,788,371 shares of common stock at \$1.0441 per share  | -   | 2   | -                              | -                               | 2   |
| <b>Total Affiliated Investments</b>  | <u>\$ 341,440</u>   | <u>\$66,388,010</u>                         | <u>\$ 8,201,132</u>            | <u>\$(1,000,000)</u>            | <u>\$73,589,142</u>                         |
| <b>Total Control &amp; Affiliated Investments</b>  | <u>\$4,771,754</u>  | <u>\$352,876,258</u>                        | <u>\$63,113,137</u>            | <u>\$(12,252,928)</u>           | <u>\$403,736,467</u>                        |

This schedule should be read in conjunction with the Company's Consolidated Financial Statements, including the Consolidated Schedules of Investments and Notes to Consolidated Financial Statements.

(1) The principal amount and ownership detail as shown in the Consolidated Schedules of Investments.

(2) Represents the total amount of interest, fees and dividends, credited to income for the portion of the year an investment was included in the Control or Non-Control/Non-Affiliate categories, respectively.

(3) Gross additions include increases in the cost basis of investments resulting from new portfolio investments, follow-on investments and accrued PIK interest, and the exchange of one or more existing securities for one or more new securities. Gross additions also include net increases in unrealized appreciation or net decreases in unrealized depreciation as well as movement of an existing portfolio company into this category and out of a different category.

(4) Gross reductions included in decreases in the cost basis of investment resulting from principal payments or sales and exchanges of one or more existing securities for one or more new securities. Gross reductions also include net increases in unrealized depreciation or net decreases in unrealized appreciation as well as the movement of an existing portfolio company out of this category and into a different category.

## Selected Per Share Data and Ratios

|   | Years Ended March |          |          |          |          |
|---|-------------------|----------|----------|----------|----------|
|   | 2010              | 2009     | 2008     | 2007     | 2006     |
| <b>Per Share Data</b>   |                   |          |          |          |          |
| Investment income .....   | \$ 1.63           | \$ 3.74  | \$ 1.75  | \$ 1.79  | \$ 1.25  |
| Operating expenses .....  | (1.04)            | (.98)    | (.76)    | (.57)    | (.51)    |
| Interest expense .....  | -                 | -        | -        | (.12)    | (.11)    |
| Income taxes .....  | (.03)             | (.04)    | (.03)    | (.01)    | (.01)    |
| Net investment income .....   | .56               | 2.72     | .96      | 1.09     | .62      |
| Distributions from undistributed net investment income .....            | (.80)             | (3.28)   | (.60)    | (.60)    | (.60)    |
| Net realized gain (loss) net of tax .....                               | .22               | 2.87     | .06      | 3.85     | 4.00     |
| Net increase (decrease) in unrealized appreciation of investments ..... | 18.88             | (42.56)  | (36.76)  | 38.00    | 32.22    |
| Treasury stock repurchase *   |                   |          |          |          |          |
| Exercise of employee stock options ** .....                             | -                 | -        | (.09)    | (.49)    | (.04)    |
| Stock option expense .....  | .18               | .13      | .07      | .04      | -        |
| Net change in pension plan funded status .....                          | .12               | (.39)    | (.30)    | -        | -        |
| Treasury Stock .....  | -                 | 1.40     | -        | -        | -        |
| Adjustment to initially apply FASB No. 158, net of tax .....            | -                 | -        | -        | .30      | -        |
| Increase (decrease) in net asset value .....                            | 19.16             | (39.11)  | (36.66)  | 42.19    | 36.20    |
| Net asset value   |                   |          |          |          |          |
| Beginning of year .....   | 110.98            | 150.09   | 186.75   | 144.56   | 108.36   |
| End of year .....   | \$130.14          | \$110.98 | \$150.09 | \$186.75 | \$144.56 |
| <b>Ratios and Supplemental Data</b>                                     |                   |          |          |          |          |
| Ratio of operating expenses to average net assets .....                 | .87%              | .71%     | .46%     | .36%     | .42%     |
| Ratio of net investment income to average net assets .....              | .47%              | 1.96%    | .58%     | .68%     | .51%     |
| Portfolio turnover rate .....   | 1.16%             | 2.51%    | .22%     | .13%     | 2.36%    |
| Net asset value total return .....                                      | 18.50%            | (22.56)% | (19.27)% | 29.85%   | 34.31%   |
| Shares outstanding at end of period (000s omitted) .....                | 3,741             | 3,741    | 3,889    | 3,886    | 3,860    |

\* Net increase is due to purchases of common stock at prices less than beginning period net asset value.

\*\*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. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of the Company's principal executive and principal financial officers and effected by the Company's Board of Directors, management and other personnel 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 and include those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- 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
- 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 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 condi-

tions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of our internal control over financial reporting as of March 31, 2010. In making this assessment, management used the criteria described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on the results of this assessment, management (including our Chief Executive Officer and our Chief Financial Officer) has concluded that, as of March 31, 2010, the Company's internal control over financial reporting was effective.

The effectiveness of the Company's internal control over financial reporting has been audited by Grant Thornton LLP, the independent registered public accounting firm, as stated in their report which appears on the next page of this Annual Report on Form 10-K.

Date: May 28, 2010

/s/ Gary L. Martin

Gary L. Martin

Chairman of the Board and President

/s/ Tracy L. Morris

Tracy L. Morris

Chief Financial Officer

(chief financial/accounting officer)



## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders  
Capital Southwest Corporation

We have audited Capital Southwest Corporation (a Texas Corporation) and subsidiaries', (the "Company") internal control over financial reporting as of March 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions

and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of assets and liabilities of the Company as of March 31, 2010 and 2009, including the schedule of investments as of March 31, 2010 and 2009, and the related consolidated statements of operations, changes in net assets and cash flows for each of the three years in the period ended March 31, 2010, and the selected per share data and ratios for each of the five years in the period ended March 31, 2010, and our report dated May 28, 2010 expressed an unqualified opinion and included explanatory paragraphs regarding the Company's adoption of ASC 820, "Fair Value Measurements and Disclosures."

/s/Grant Thornton, LLP  
Dallas, Texas  
May 28, 2010

## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders  
Capital Southwest Corporation

We have audited the accompanying consolidated statements of assets and liabilities of Capital Southwest Corporation (a Texas Corporation) and subsidiaries (the "Company") as of March 31, 2010 and 2009, including the schedule of investments as of March 31, 2010 and 2009, and the related consolidated statements of operations, changes in net assets, and cash flows for each of the three years in the period ended March 31, 2010, and the selected per share data and ratios for each of the five years in the period ended March 31, 2010. Our audits of the basic financial statements included the Schedule of Investments In and Advances to Affiliates. These financial statements, per share data and ratios and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements, per share data and ratios and financial statement schedule 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 and selected per share data and ratios are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included verification by examination of securities held by the custodian as of March 31, 2010 and 2009, and confirmation of securities not held by the custodian. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements and the selected per share data and ratios referred to above present fairly, in all material respects, the financial position of Capital Southwest Corporation and subsidiaries as of March 31, 2010 and 2009, and the results of their operations, changes in their net assets, and their cash flows for each of the three years in the period ended March 31, 2010, and the selected per share data and ratios for each of the five years in the period ended March 31, 2010, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 2 to the accompanying consolidated financial statements, effective April 1, 2008, the Company adopted Accounting Standard Codification (ASC) 820, "Fair Value Measurements and Disclosures."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Capital Southwest Corporation and subsidiaries' internal control over financial reporting as of March 31, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated May 28, 2010, expressed an unqualified opinion thereon.

/s/ Grant Thornton LLP  
Dallas, Texas  
May 28, 2010

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Results of Operations

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

#### *Net Investment Income*

The Company's principal objective is to achieve capital appreciation. Therefore, a significant portion of the investment portfolio is structured to maximize the potential return from equity participation and provides minimal current yield in the form of interest or dividends. The Company also earns interest income from the short-term investment of cash funds, and the annual amount of such income varies based upon

the average level of funds invested during the year and fluctuations in short-term interest rates. During the three years ended March 31, the Company had interest income from temporary cash investments of \$19,618 in 2010, \$381,498 in 2009 and \$1,421,048 in 2008. The Company also receives management fees primarily from its controlled affiliates which aggregated \$984,800 in 2010, \$984,800 in 2009 and \$784,800 in 2008. During the three years ended March 31, 2010, the Company recorded dividend income from the following sources:

|   | Years Ended March 31 |                     |                    |
|---|----------------------|---------------------|--------------------|
|   | 2010                 | 2009                | 2008               |
| Alamo Group Inc. ....                   | \$ 679,272           | \$ 679,272          | \$ 678,732         |
| Balco, Inc.....                         | -                    | -                   | 224,400            |
| Dennis Tool Company.....                | 33,333               | 49,499              | 62,499             |
| Encore Wire Corporation .....           | 326,940              | 326,940             | 326,940            |
| Heelys, Inc.....                        | -                    | 9,317,310           | -                  |
| Kimberly-Clark Corporation.....         | -                    | 89,529              | 167,481            |
| Lifemark Group .....                    | -                    | -                   | 571,333            |
| PalletOne, Inc.....                     | -                    | -                   | -                  |
| The RectorSeal Corporation.....         | 2,117,870            | 720,000             | 1,154,133          |
| Sprint Nextel Corporation .....         | -                    | -                   | 6,750              |
| TCI Holdings, Inc. ....                 | 81,270               | 81,270              | 81,270             |
| The Whitmore Manufacturing Company .... | 529,467              | 180,000             | 288,533            |
| Other.....                              | <u>20,528</u>        | <u>89,558</u>       | <u>94,762</u>      |
|   | <u>\$3,788,680</u>   | <u>\$11,533,878</u> | <u>\$3,656,833</u> |

Total operating expenses, increased by \$238,007 or 6.5% during the year ended March 31, 2010. While, total operating expenses, increased by \$697,177 or 23.5% during the year ended March 31, 2009. Due to the nature of its business, the majority of the Company's operating expenses are related to employee and director compensation, office expenses, legal, professional and accounting fees and the net pension benefit.

### *Net Realized Gain (Loss) on Investments*

Net realized gain on investments was \$1,639,994 (after income tax expense of \$814,503) during the year ended March 31, 2010, compared with a gain of \$10,756,302 (after income tax expense of \$5,222,964) during 2009 and a gain of \$240,024 during 2008. 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/(Decrease) in Unrealized Appreciation of Investments*

For the three years ended March 31, the Company recorded an increase in unrealized appreciation of investments of \$70,624,231, in 2010 and a decrease of \$159,247,203, in 2009 and a decrease of \$142,969,698 in 2008. As explained in the first paragraph of this discussion and analysis, the realization of gains or losses results in a corresponding decrease or increase in unrealized appreciation of investments. Set forth in the following table are the significant increases and decreases in unrealized appreciation excluding the effect of gains or losses realized during the year by portfolio company for securities held at the end of each year.

|  | Years Ended March 31 |                |               |
|--|----------------------|----------------|---------------|
|  | 2010                 | 2009           | 2008          |
| Alamo Group Inc. ....                    | \$19,812,100         | \$(22,642,400) | \$(2,803,090) |
| All Components, Inc. ....                | 9,276,649            | (9,600,000)    | 5,600,000     |
| Encore Wire Corporation .....            | 2,043,375            | 14,303,625     | (18,390,625)  |
| Heelys, Inc. ....                        | 5,869,905            | (20,963,948)   | (160,724,088) |
| The Whitmore Manufacturing Company ..... | 11,500,000           | (2,000,000)    | 12,000,000    |
| Lifemark Group .....                     | -                    | -              | 31,000,000    |
| Media Recovery, Inc. ....                | (1,400,000)          | (22,700,000)   | (7,500,000)   |
| Palm Harbor Homes, Inc. ....             | (2,984,947)          | (21,601,583)   | (39,275,516)  |
| The RectorSeal Corporation.....          | 13,000,000           | (37,000,000)   | 46,200,000    |

As shown in the table for the year ended March 31, 2010, we sustained significant increases in several of our largest investments. The largest increases in unrealized appreciation are attributable to Alamo Group, Inc., which increased \$19,812,100; Heelys, Inc., which increased \$5,869,905; Encore Wire Corporation, which increased \$2,043,375, all due to an increase in their respective stock prices; as well as All Components, Inc., which increased \$9,726,649 as a result of debt reduction on its senior credit facility. The \$13,000,000 increase in The RectorSeal Corporation was primarily attributable to the impact of increased valuations of companies operating within their respective sector. The \$11,500,000 increase in The Whitmore Manufacturing Company was attributable to improved earnings. Offsetting these increases were Media Recovery, Inc., which decreased \$1,400,000 due to slowdowns in certain segments of their business; and Palm Harbor Homes, Inc., which decreased \$2,984,947, due to a reduction in their stock price.

A description of the investments listed above and other material components of the investment portfolio are included elsewhere in this report under the caption "Consolidated Schedule of Investments - March 31, 2010 and 2009."

### **Portfolio Investments**

During the year ended March 31, 2010, the Company invested \$17,234,456 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 2009 and 2008 fiscal years, the Company invested a total of \$13,030,107 and \$10,733,536, respectively.

### **Financial Liquidity and Capital Resources**

At March 31, 2010, the Company had cash and cash equivalents of approximately \$4.1 million. Pursuant to the Small Business Administration ("SBA") regulations, cash and cash equivalents of \$2.7 million

held by CSVC may not be transferred or advanced to CSC without the consent of the SBA.

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 41 years. Retention of future gains is viewed as an important source of funds to sustain the Company's investment activity. Approximately \$21.0 million of the Company's investment portfolio is represented by unrestricted publicly traded securities and represent a source of liquidity.

Funds to be used by the Company for operating or investment purposes may be transferred in the form of dividends, management fees or loans from Lifemark Group, The RectorSeal Corporation and The Whitmore Manufacturing Company, controlled affiliates 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, 2010. For information on our capital commitments see Note 8 of the Consolidated Financial Statements.

| <b>Contractual Obligations</b> | <b>Payments Due By Period (\$ in Thousands)</b> |               |                  |                          |
|--------------------------------|---|---------------|------------------|--------------------------|
|                                | <b>Total</b>                                    | <b>1 Year</b> | <b>2-3 Years</b> | <b>More Than 3 Years</b> |
| Operating lease obligations    | \$312   | \$101         | \$202            | \$9                      |
| Total                          | \$312   | \$101         | \$202            | \$9                      |

### Critical Accounting Policies

#### *Valuation of Investments*

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

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

#### **Impact of Inflation**

The Company does not believe that its business is materially affected by inflation, other than the impact which inflation may have on the securities markets, the valuations of business enterprises and the

relationship of such valuations to underlying earnings, all of which will influence the value of the Company's investments.

### **Risks**

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

*The Company's objective is to achieve capital appreciation through investments in businesses believed to have favorable growth potential.*

*Such businesses are often undercapitalized small companies which lack management depth and have not yet attained profitability. The Company's venture investments often include securities which do not yield interest or dividends and are subject to legal or contractual restrictions on resale, which restrictions adversely affect the liquidity and marketability of such securities.*

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

## Selected Consolidated Financial Data

*(all figures in thousands except per share data)*

|   | 2001            | 2002           | 2003            | 2004           | 2005           | 2006           | 2007           | 2008             | 2009             | 2010           |
|---|-----------------|----------------|-----------------|----------------|----------------|----------------|----------------|------------------|------------------|----------------|
| <b>Financial Position (as of March 31)</b>  |                 |                |                 |                |                |                |                |                  |                  |                |
| Investments at cost.....  | \$ 87,602       | \$ 82,194      | \$ 91,462       | \$ 97,283      | \$ 84,546      | \$ 88,597      | \$ 71,642      | \$ 81,027        | \$ 89,339        | \$ 100,023     |
| Unrealized appreciation.....  | <u>228,316</u>  | <u>265,287</u> | <u>195,598</u>  | <u>309,666</u> | <u>337,476</u> | <u>461,831</u> | <u>609,513</u> | <u>466,544</u>   | <u>307,296</u>   | <u>377,920</u> |
| Investments at market or<br>fair value.....   | 315,918         | 347,481        | 287,060         | 406,949        | 422,022        | 550,428        | 681,155        | 547,571          | 396,635          | 477,943        |
| Total assets.....   | 322,668         | 357,183        | 298,490         | 423,979        | 434,384        | 569,368        | 729,507        | 586,685          | 417,543          | 491,175        |
| Notes payable * .....   | 16,000          | 14,000         | 23,000          | 20,500         | 13,000         | 8,000          | -              | -                | -                | -              |
| Net assets .....  | 303,436         | 339,891        | 272,211         | 400,157        | 417,947        | 558,036        | 725,732        | 583,700          | 415,263          | 486,926        |
| Shares outstanding.....   | 3,815           | 3,829          | 3,829           | 3,857          | 3,857          | 3,860          | 3,886          | 3,889            | 3,741            | 3,741          |
| <b>Changes in Net Assets (years ended March 31)</b>                                 |                 |                |                 |                |                |                |                |                  |                  |                |
| Net investment income .....   | \$ 1,723        | \$ 2,042       | \$ 2,299        | \$ 2,587       | \$ 2,406       | \$ 2,389       | \$ 4,233       | \$ 3,715         | \$ 10,183        | 2,091          |
| Net realized gain (loss) on<br>investments .....                                    | (5,126)         | (762)          | 2,007           | 12,603         | (10,112)       | 15,451         | 14,966         | 240              | 10,756           | 826            |
| Net increase (decrease) in<br>unrealized appreciation<br>before distributions ..... | <u>(10,311)</u> | <u>36,971</u>  | <u>(69,689)</u> | <u>114,068</u> | <u>27,810</u>  | <u>124,355</u> | <u>147,682</u> | <u>(142,969)</u> | <u>(159,246)</u> | <u>70,624</u>  |
| Increase (decrease) in net<br>assets from operations<br>before distributions .....  | (13,714)        | 38,251         | (65,383)        | 129,258        | 20,104         | 142,195        | 166,881        | (139,014)        | (138,307)        | 73,541         |
| Cash dividends paid .....   | (2,289)         | (2,295)        | (2,297)         | (2,309)        | (2,314)        | (2,314)        | (2,323)        | (2,333)          | (12,257)         | (2,993)        |
| Employee stock options<br>exercised.....  | -               | 499            | -               | 997            | -              | 208            | 1,795          | 231              | -                | -              |
| Stock option expense .....  | -               | -              | -               | -              | -              | -              | 169            | 263              | 503              | 675            |
| Change in pension plan<br>funded status.....  | -               | -              | -               | -              | -              | -              | -              | (1,178)          | (1,473)          | 440            |
| Treasury stock.....   | -               | -              | -               | -              | -              | -              | -              | -                | (16,903)         | -              |
| Adjustment to initially apply FASB<br>Statement No. 158, net of tax..               | -               | -              | -               | -              | -              | -              | 1,173          | -                | -                | -              |
| Increase (decrease) in net assets   | <u>(16,003)</u> | <u>36,455</u>  | <u>(67,680)</u> | <u>127,946</u> | <u>17,790</u>  | <u>140,089</u> | <u>167,695</u> | <u>(142,031)</u> | <u>(168,437)</u> | <u>71,663</u>  |
| <b>Per Share Data (as of March 31)</b>  |                 |                |                 |                |                |                |                |                  |                  |                |
| Net assets .....  | \$ 79.54        | \$ 88.77       | \$ 71.09        | \$ 103.75      | \$ 108.36      | \$ 144.56      | \$ 186.75      | \$ 150.09        | \$ 110.98        | \$ 130.14      |
| Closing market price.....   | 65.00           | 68.75          | 48.15           | 75.47          | 79.10          | 95.50          | 153.67         | 123.72           | 76.39            | 90.88          |
| Cash dividends paid .....   | .60             | .60            | .60             | .60            | .60            | .60            | .60            | .60              | 3.26             | .80            |

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

## Shareholder Information

### Stock Transfer Agent

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

### Shareholders

The Company had approximately 700 record holders of its common stock at March 31, 2010. This total does not include an estimated 4,000 shareholders with shares held under beneficial ownership in nominee name or within clearinghouse positions of brokerage firms or banks.

### Market Prices

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

| Quarter Ended            | High    | Low     |
|--------------------------|---------|---------|
| March 31, 2010 .....     | \$96.04 | \$78.51 |
| December 31, 2009 .....  | 79.95   | 71.72   |
| September 30, 2009 ..... | 82.90   | 69.60   |
| June 30, 2009 .....      | 84.21   | 67.60   |

| Quarter Ended            | High     | Low     |
|--------------------------|----------|---------|
| March 31, 2009 .....     | \$109.66 | \$53.57 |
| December 31, 2008 .....  | 141.50   | 60.52   |
| September 30, 2008 ..... | 146.81   | 102.02  |
| June 30, 2008 .....      | 128.99   | 103.67  |

### Dividends

The payment dates and amounts of cash dividends per share since

April 1, 2008 are as follows:

| Payment Date            | Cash Dividend |
|-------------------------|---------------|
| May 30, 2008 .....      | \$0.40        |
| October 31, 2008 .....  | 0.30          |
| November 28, 2008 ..... | 0.40          |
| December 26, 2008 ..... | 2.16          |
| May 29, 2009 .....      | 0.40          |
| November 30, 2009 ..... | 0.40          |

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

### Automatic Dividend Reinvestment and Optional Cash Contribution Plan

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

### Annual Meeting

The Annual Meeting of Shareholders of Capital Southwest Corporation will be held on Monday, July 19, 2010, at 10:00 a.m. in the North Dallas Bank Tower Meeting Room (second floor), 12900 Preston Road, Dallas, Texas 75230.



## Dividend Reinvestment Plan – Questions and Answers

### ***What are the benefits of joining the Plan?***

- As a participant in the Automatic Dividend Reinvestment and Optional Cash Contribution Plan, your dividends are reinvested and you may make cash contributions of \$100 to \$10,000 in any month to purchase additional shares of Capital Southwest Corporation stock for your plan account.
- Because purchases are made on a pooled basis, transaction costs should be less than those associated with individual purchases of small numbers of shares.

### ***Who is eligible to join?***

Only holders of record of 25 or more shares are eligible. If your shares are held in the name of a broker or other nominee, you must instruct your broker or nominee to register the shares directly in your name.

### ***Is there any cost to participate in the Plan?***

You pay only your share of transaction costs, which are included in the price of purchased shares. Capital Southwest pays all costs of administration.

### ***How does the automatic dividend reinvestment feature work?***

The Plan, available to all shareholders of record of 25 or more shares, provides a convenient way to acquire additional shares. After you join, cash dividends on your shares (including shares you hold and shares in your plan account), or on a lesser number of shares you may specify, will automatically be reinvested by American Stock Transfer & Trust Company as your agent.

### ***May I deposit Shares for safekeeping?***

Although not required, you may deposit share certificates registered in your name for addition to your plan account. The agent will automatically reinvest dividends on all shares in your plan account.

### ***How does the optional cash contribution feature work?***

To make voluntary cash purchases, you first must join the Plan and

participate in the automatic dividend reinvestment feature. Contributions for voluntary cash purchases of \$100 to \$10,000 in any month can then be made by sending a check to the agent, together with the remittance form which accompanies each plan account statement.

Contributions can also be made by completing an automatic cash withdrawal authorization form, enabling you to make regular monthly purchases with funds transferred from your bank account.

### ***What statements will I receive?***

Each time shares are purchased, you will receive a statement showing the total shares in your plan account, the amount of the latest reinvested dividend or optional cash contribution, the number of shares purchased and the price per share.

### ***How is information reported for income tax purposes?***

Reinvested dividends are subject to income tax to the same extent as if received in cash. You will receive a Form 1099 information return regarding the Federal income tax status of all dividends paid during the year.

### ***How would I terminate my participation in the Plan?***

You may terminate your participation at any time by giving notice to the agent. Upon termination, you will receive a certificate for the number of shares then held in your plan account, plus a check for any fractional share interest.

### ***How do I join the Plan?***

Call Capital Southwest at (972) 233-8242 for a plan brochure and authorization form. Then, sign and return the authorization form to American Stock Transfer & Trust Company, Dividend Reinvestment Dept., P.O. Box 922 Wall Street Station, New York, NY 10269-0560. Your name or names should be signed as they appear on your stock certificates. You may register all of your shares in the Plan or such lesser number of shares (a minimum of 25) as you indicate.

## Federal Income Tax Information

### For Shareholders on December 31, 2009

Capital Southwest Corporation ("CSC") elected to retain the taxable net long-term capital gains realized during its taxable year ended December 31, 2009, and pay the applicable Federal income tax, as shown below on a per share basis.

|                                      |                    |
|--------------------------------------|--------------------|
| Net long-term capital gains retained | \$0.622 per share  |
| Federal income tax paid              | \$0.2177 per share |

In accordance with the Internal Revenue Code, shareholders of record on December 31, 2009 were required to include their pro rata portion (\$0.622 per share) of these gains on Schedule D of their 2009 Federal tax returns and are entitled to a credit for, or a refund of, their pro rata portion (\$0.2177 per share) of the Federal income tax paid by CSC. This payment will ordinarily exceed the corresponding tax liability and result in a net credit or refund.

Each shareholder is deemed to have reinvested the amount constructively distributed (less the tax), and accordingly is entitled to increase the cost basis of his shares by \$0.4043 per share. This will reduce the future tax liability when those shares of CSC are sold.

Internal Revenue Service Form 2439 was mailed to all shareholders of record on December 31, 2009 setting forth the specific amounts to be included in each shareholder's 2009 tax return. This form was accompanied by a detailed instruction letter entitled "Important Tax Information" dated January 29, 2010, which contained tax information applicable to all shareholders. This instruction letter also described the procedure to be used by tax-exempt shareholders such as pension trusts and individual retirement accounts to obtain a cash refund of \$0.2177 per share by filing IRS Form 990-T.

Nominees who received Form 2439 were required to issue a supplemental Form 2439 to beneficial owners at December 31, 2008. If you owned shares of CSC which were held in the name of a broker or other nominee and have not received a supplemental Form 2439, you should request Form 2439 from the record holder to substantiate the available 2009 tax benefits.

### For Shareholders from 1968 through 2008

In certain years from 1968 through 2009, CSC made elections to retain taxable net long-term capital gains. The table below shows the record dates for all years for which CSC made such elections and the per share amounts of the retained long-term capital gains, the Federal income taxes paid and the amounts by which shareholders on each record date are entitled to increase the tax basis of each share (adjusted for stock splits in 1976, 1981 and 1987):

| <u>Record date</u> | <u>Retained<br/>capital gains<br/>per share</u> | <u>Federal income<br/>taxes paid<br/>per share</u> | <u>Increase in<br/>tax basis<br/>per share</u> |
|--------------------|---|--|--|
| March 31, 1968     | \$0.5041  | \$0.1292   | \$0.3749                                       |
| March 31, 1969     | 0.3102  | 0.0852   | 0.2250   |
| March 31, 1970     | 0.2366  | 0.0662   | 0.1704   |
| March 31, 1983     | 1.2106  | 0.3390   | 0.8716   |
| March 31, 1984     | 0.1797  | 0.0503   | 0.1294   |
| March 31, 1985     | 0.3469  | 0.0971   | 0.2498   |
| December 31, 1986  | 3.2523  | 0.9106   | 2.3417   |
| December 31, 1989  | 3.2378  | 1.1008   | 2.1370   |
| December 31, 1991  | 5.9375  | 2.0187   | 3.9188   |
| December 31, 1992  | 2.0823  | 0.7080   | 1.3743   |
| December 31, 1996  | 4.7546  | 1.6641   | 3.0905   |
| December 31, 1997  | 4.9821  | 1.7437   | 3.2384   |
| December 31, 1998  | 0.2001  | 0.0700   | 0.1301   |
| December 31, 1999  | 3.0474  | 1.0666   | 1.9808   |
| December 31, 2005  | 3.5761  | 1.2516   | 2.3245   |
| December 31, 2006  | 8.1469  | 2.8514   | 5.2955   |
| December 31, 2008  | 3.9883  | 1.3959   | 2.5924   |
| December 31, 2009  | 0.6220  | 0.2177   | 0.4043   |

## Professionals

**Gary L. Martin**, Chairman of the Board and President, joined Capital Southwest in 1972 and served as Chief Financial Officer, subsequently serving as Vice President and Secretary-Treasurer. From 1979 to 2007, he served as President and Chief Executive Officer of The Whitmore Manufacturing Company, a portfolio company of Capital Southwest. His previous experience included a financial management position within the commercial development industry. He earned a BBA degree from the University of Oklahoma.

**William M. Ashbaugh**, Senior Vice President, joined Capital Southwest in 2001. Previously, he served as Managing Director in the corporate finance departments of Hoak Breedlove Wesneski & Co., Principal Financial Securities, Inc. and Southwest Securities and as First Vice President, Corporate Finance, with Rauscher Pierce Refsnes (now RBC Dain Rauscher). His experience includes direction of public offerings, private placements and merger and acquisition transactions. He holds an MBA summa cum laude from The University of Texas at Austin and a BS summa cum laude from Texas A&M University.

**Marquez D. Bela**, Vice President, joined Capital Southwest in 2010. Previously, he served as Managing Member of Covalent Capital, a private equity firm focused on early stage to mid-size companies. Prior to Covalent Capital, he was with SKM Growth Investors, an affiliate of Saunders Karp and Megrue, a \$1.5 billion equity fund. His previous experience includes operational consulting and investment banking with Goldman Sachs's high technology practice. He graduated from the University of Texas at Austin, where he received a B.A. from the Plan II Honors Program and a B.B.A in finance from the Business Honors Program.

**Glenn M. Neblett**, Vice President, joined Capital Southwest in 2010. Previously, he served as Director in the corporate finance and financial sponsors groups at Houlihan Lokey, where he advised clients in mergers and acquisitions, private placements and restructurings. He holds undergraduate and graduate degrees from Baylor University, and is a Chartered Financial Analyst and Certified Public Accountant.

**Ray D. Schwertner**, Vice President, joined Capital Southwest in 2009. Previously, he served as President and Chief Executive Officer of The Whitmore Manufacturing Company, a portfolio company of Capital Southwest, from 2007 to 2009 and as Secretary-Treasurer from 1990 to 2007. His previous experience included a financial management position in the manufacturing industry and in public accounting. He earned a BBA degree from Angelo State University and is a Certified Public Accountant.

**Tracy L. Morris**, Chief Financial Officer, Chief Compliance Officer and Corporate Secretary, joined Capital Southwest in 2007. Previously, she served as Controller of Best Merchant Partners, LP and Silverleaf Resorts, Inc. She received a BS degree from Millersville University of Pennsylvania and is a Certified Public Accountant.

**William R. Thomas III**, Assistant Vice President, joined Capital Southwest in 2006. Previously, Will served as a U.S. Air Force officer in varied positions including chief pilot of an airlift group, director of logistics operations and chief of aircraft development contracts. He has also served as a consultant for Investor Group Services, where he analyzed potential investments in mid-market companies. He has an MBA from Harvard Business School and a BS in engineering sciences from the U.S. Air Force Academy.