

To Our Shareholders

Net Asset Value at March 31, 2009 was \$415,262,991 equivalent to \$110.98 per share. Assuming reinvestment of all dividends and tax credits on long-term capital gains, the March 31, 2009 net asset value was 22.6% below the March 31, 2008 net value of \$150.09 per share and 13.1% below the December 31, 2008 net asset value of \$127.68 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 <u>March 31, 2009</u>
Increases (decreases) in unrealized gains:	
The RectorSeal Corporation.....	\$ (9.89)
Media Recovery, Inc.	(6.07)
Alamo Group, Inc.	(6.05)
Palm Harbor Homes, Inc.	(5.77)
Heelys, Inc.	(5.60)
Encore Wire Corporation.....	3.82
Other decreases.....	(13.00)
Net realized gains.....	2.87
Net investment income.....	2.72
Dividends.....	(3.26)
Other changes in net assets.....	<u>1.12</u>
Decreases in net asset value.....	(39.11)
Net asset value beginning of period.....	<u>150.09</u>
Net asset value end of period.....	<u>\$110.98</u>

Moving Parts

Subdividing our March 31, 2009 investment portfolio into four categories reveals that 57.7% of the value of our holdings is concentrated in four controlled affiliates; 28.2% is in the restricted securities of four

major publicly traded investments; 10.6% is in venture capital assets; and the remainder is in marketable securities. The following analysis reflects the changes in the four categories as compared to the same categories at March 31, 2008.

	<u>March 31, 2009</u>		<u>March 31, 2008</u>	
	% of Total		% of Total	
	<u>Market Value</u>	<u>Investments</u>	<u>Market Value</u>	<u>Investments</u>
Controlled Affiliates (mainly)				
The RectorSeal Corporation	\$107,200,000	27.0	\$144,200,000	26.3
Lifemark Group.....	71,000,000	17.9	71,000,000	13.0
The Whitmore Manufacturing Co.	36,000,000	9.1	38,000,000	6.9
Media Recovery, Inc.	14,800,000	3.7	37,500,000	6.9
Major Publicly Traded Investments				
Encore Wire Corporation.....	65,388,000	16.5	51,084,375	9.3
Alamo Group, Inc.	22,642,400	5.7	45,284,800	8.3
Heelys, Inc.	13,975,965	3.5	34,939,913	6.4
Palm Harbor Homes, Inc.	9,818,901	2.5	31,420,484	5.7
Venture Capital Assets.....	42,023,841	10.6	41,414,247	7.6
Marketable Securities	<u>13,785,916</u>	<u>3.5</u>	<u>52,276,683</u>	<u>9.6</u>
Total	<u>\$396,635,023</u>	<u>100.0</u>	<u>\$547,570,502</u>	<u>100.0</u>

Market value erosion in the controlled affiliates category was primarily attributable to The RectorSeal Corporation's earnings decline associated with construction-related markets. Within the major publicly traded investment category, the depressed construction and housing markets impacted Palm Harbor Homes to a great extent. Alamo Group experienced sales and earnings declines as municipal and state purchasing activities were deferred as budgets contracted. The decline in Heelys value includes general market price erosion and the receipt of a special dividend in the amount of \$9,317,310.

For the year ended March 31, 2009, marketable securities were valued in the aggregate amount of \$13,785,916, representing a \$38,490,767 decrease from their value of \$52,276,683 for the year ended March 31, 2008. During the year ended March 31, 2009 we sold \$20,655,026 of our unrestricted marketable securities at a rea-

lized gain of \$15,984,688 or \$4.27 per share. The sale of unrestricted marketable securities provided funding for our share repurchase plan and cash for new investments. The remaining unrestricted marketable securities experienced a decrease in value of \$12,065,545 or \$3.22 per share during the year.

In addition to a complete list of our investments, this report includes a description of our twelve largest holdings (see pages 5 through 7). These twelve investments had a combined cost of \$38,324,183 and have a combined value of \$367,811,182, representing 92.7% of the value of our investment portfolio at March 31, 2009.

Regardless of its classification or current form, substantially 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 growth in net asset value over the past 10 years corresponded to a compounded annual rate of 2.2%, assuming reinvestment of all dividends and tax credits on long-term capital gains retained by the Company. On the same basis, the growth over the 5-year period ended March 31, 2009 was equivalent to a compound annual rate of 2.3%. 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	**S&P 500
<u>March 31, 2009</u>	<u>Southwest</u>	<u>Stock Index</u>
5 years	2.3%	(4.8)%
10 years	2.2%	(3.0)%

* 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

During the year ended March 31, 2009 we experienced higher levels of qualified investment opportunities as many traditional funding sources for expansion capital contracted. Furthermore, a new robust business development effort, fortified with a comprehensive marketing plan, achieved positive results in conveying our strong, patient capital message.

The Company invested an aggregate of \$13,030,107 directly into new or existing portfolio companies during the year ended March 31, 2009. Significant new investments were:

- \$5,391,649 of a \$6,995,349 commitment was invested in Cinatra Clean Technologies, Inc., a provider of hydrocarbon recovery and cleaning of above ground oil storage tanks with a patented, automated system. Capital Southwest's fully diluted interest is 59.2%.
- \$5,000,000 invested in Trax Holdings, Inc, which provides automated business processes to the transportation industry. Capital Southwest's fully diluted ownership is 32.5%.
- \$1,309,541 of its \$6,000,000 commitment to BankCap Partners Fund I, LP.
- \$450,000 of a \$900,000 commitment was invested in Discovery Alliance, LLC, formed to acquire intellectual property focused initially on our existing controlled portfolio companies. Capital Southwest's fully diluted ownership is 90%.
- \$325,876 in Extreme International, Inc. to exercise warrants. Capital Southwest's fully diluted ownership is 53.63%.

Additionally, during the year ended March 31, 2009, \$14,100,000 and \$4,000,000 were invested by The RectorSeal Corporation and Media Recovery, Inc. to make strategic acquisitions in their respective businesses.

Every \$1.00 we directly invest includes approximately \$0.20 owned by our management and directors. Accordingly our investment decisions are very thoughtful and our monitoring duties are thorough.

Down the Road

Looking back, the past year presented us with many challenges: the passing of William R. "Bill" Thomas, our former President and Chairman; the economies of the U.S. and many other countries dipping into recession; the decline in overall consumer confidence; and the continued uncertainty about our country's overall economic stability. Even during these uncertain times, we continued to invest in new ventures, add onto existing investments, and expand our professional staff. Overall business development activity generated \$11.3 million of new

venture investments, \$1.7 million of add-on funding to existing portfolio companies and \$18.1 million invested in strategic acquisitions completed by two of our controlled portfolio companies. As we look to the future, we continue to safeguard our cash reserves to meet a higher level of potential investment opportunities during the year. While we cannot anticipate when the current economy will stabilize, we will continue to be steadfast in our commitment to capital appreciation through venture investing and supporting our existing portfolio companies in their continued growth and success.

June 2, 2009

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 48 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 64% of the value of our portfolio.

Twelve Largest Investments – March 31, 2009

The RectorSeal Corporation	\$107,200,000
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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 page 5).

During the year ended March 31, 2009, RectorSeal earned \$10,170,000 on revenues of \$111,792,000, compared with earnings of \$11,649,000 on revenues of \$112,029,000 in the previous year. RectorSeal's earnings do not reflect its 20% equity in The Whitmore Manufacturing Company.

At March 31, 2009, Capital Southwest owned 100% of RectorSeal's common stock having a cost of \$52,600 and a value of \$107,200,000.

Encore Wire Corporation	\$65,388,000
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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, 2008, Encore reported net income of \$39,771,000 (\$1.72 per share) on net sales of \$1,081,132,000, compared with net income of \$30,796,000 (\$1.32 per share) on net sales of \$1,184,786,000 in the previous year. The March 31, 2009 closing Nasdaq bid price of Encore's common stock was \$21.41 per share.

At March 31, 2009, 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 \$65,388,000 (\$16.00 per share), representing a fully-diluted equity interest of 17.2%.

Lifemark Group	\$71,000,000
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Lifemark Group, Hayward, California, owns and operates cemeteries, funeral homes, mausoleums and mortuaries. Lifemark's operations, all of which are in California, include a major cemetery and funeral home in San Mateo, a mausoleum and an adjacent mortuary in Oakland and cemeteries, mausoleums and mortuaries in Hayward and Sacramento. The company also owns a funeral home in San Bruno. Its funeral and cemetery trusts enable Lifemark's clients to make pre-need arrangements. The company's assets also include excess real estate holdings.

For the fiscal year ended March 31, 2009, Lifemark reported earnings of \$635,000 on revenues of \$28,193,000, compared with earnings of \$529,000 on revenues of \$29,682,000 in the previous year.

At March 31, 2009, 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.

The Whitmore Manufacturing Company	\$36,000,000
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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, 2009, Whitmore reported net income of \$3,209,000 on net sales of \$28,163,000, compared with net income of \$2,879,000 on net sales of \$23,148,000 in the previous year. The company is owned 80% by Capital Southwest and 20% by Capital Southwest's subsidiary, The RectorSeal Corporation (described on page 5).

At March 31, 2009, the direct investment in 80% of Whitmore by Capital Southwest was valued at \$36,000,000 and had a cost of \$1,600,000.

Alamo Group Inc. \$22,642,400

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

For the year ended December 31, 2008, Alamo reported net income of \$10,999,000 (\$1.11 per share) on net sales of \$557,135,000, compared with net income of \$12,365,000 (\$1.24 per share) on net sales of \$504,386,000 in the previous year. The March 31, 2009 closing NYSE market price of Alamo's common stock was \$10.66 per share.

At March 31, 2009, the \$2,190,937 investment in Alamo by Capital Southwest and its subsidiary was valued at \$22,642,400 (\$8.00 per share), consisting of 2,830,300 restricted shares of common stock, representing a fully-diluted equity interest of 26.0%.

Heelys, Inc. \$13,975,965

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

During the year ended December 31, 2008, Heelys reported net loss of \$5,924,000 (-\$0.22 per share) on net sales of \$70,741,000, compared with net income of \$22,317,000 (\$0.79 per share) on net sales of \$183,472,000 in the previous year. The March 31, 2009 closing Nasdaq bid price of Heelys's common stock was \$1.70 per share.

At March 31, 2008, the \$102,490 investment in Heelys by Capital Southwest's subsidiary was valued at \$13,975,965 (\$1.50 per share), consisting of 9,317,310 restricted shares of common stock, representing a fully-diluted equity interest of 31.1%.

Media Recovery, Inc. \$14,800,000

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

During the year ended September 30, 2008, Media Recovery reported net income of \$4,354,000 on net sales of \$132,864,000, compared with net income of \$4,744,000 on net sales of \$134,180,000 in the previous year.

At March 31, 2009, the \$5,415,000 investment in Media Recovery by Capital Southwest and its subsidiary was valued at \$14,800,000, 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 97.1%.

Palm Harbor Homes, Inc. \$9,818,901

Palm Harbor Homes, Dallas, Texas, is an integrated manufacturer and retailer of manufactured and modular housing produced in 9 plants and sold in 29 states by 86 company-owned retail stores and builder locations and approximately 150 independent dealers, builders and developers.

During the year ended March 27, 2009, Palm Harbor reported a net loss of \$26,304,000 (-\$1.15 per share) on net sales of \$409,274,000, compared with net loss of \$124,262,000 (-\$5.44 per share) on net sales of \$555,096,000 for the year ended March 28, 2008. The March 31, 2009 closing Nasdaq bid price of Palm Harbor's common stock was \$2.21 per share.

At March 31, 2009, the \$10,931,955 investment in Palm Harbor by Capital Southwest and its subsidiary was valued at \$9,818,901 (\$1.25 per share), consisting of 7,855,121 restricted shares of common stock, representing a fully-diluted equity interest of 31.5%.

Hologic, Inc. **\$8,277,286**

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 27, 2008, Hologic reported net loss of \$385,617,000 (-\$1.57 per share) on net sales of \$1,674,499,000, compared with net income of \$94,578,000 (\$0.86 per share) on net sales of \$738,368,000 in the previous year. The March 31, 2009 closing Nasdaq bid price of Hologic's common stock was \$13.08 per share.

At March 31, 2009, Capital Southwest and its subsidiary owned 632,820 unrestricted shares of common stock, having a cost of \$220,000 and a market value of \$8,277,288 (\$13.08 per share).

Extreme International, Inc. **\$6,600,000**

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

During the year ended September 30, 2008, Extreme reported net income of \$1,435,000 on net sales of \$11,545,000, compared with net income of \$1,688,000 on net sales of \$12,470,000 in the previous year.

At March 31, 2009, 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 \$6,600,000, representing a fully-diluted equity interest of 53.6%.

Balco, Inc. **\$6,600,000**

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, 2008, Balco reported net income of \$841,000 on net sales of \$14,035,000, compared with net income of \$920,000 on net sales of \$15,237,000 in the previous year.

At March 31, 2009, the \$624,920 investment in Balco by Capital Southwest was valued at \$6,600,000 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%.

Texas Capital Bancshares, Inc. **\$5,508,630**

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

For the year ended December 31, 2008, Texas Capital reported net income of \$24,266,000 (\$0.87 per share), compared with net income of \$29,422,000 (\$1.10 per share) in the previous year. The March 31, 2009 closing Nasdaq bid price of Texas Capital's common stock was \$11.25 per share.

At March 31, 2009, Capital Southwest owned 489,656 unrestricted shares of common stock, having a cost of \$3,550,006 and a market value of \$5,508,630 (\$11.25 per share).

Consolidated Statement of Investments – March 31, 2009

Company	Equity (a)	Investment (b)	Cost	Value (c)
†ALAMO GROUP INC. Seguin, Texas 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
ALL COMPONENTS, INC. Austin, Texas 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) 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) Warrants to purchase 350,000 shares of common stock at \$11.00 per share, expiring 2017 (acquired 6-27-07)	6,000,000 150,000 — 6,150,000	3,000,000 1 — 3,000,001
ATLANTIC CAPITAL BANCSHARES, INC. Atlanta, Georgia 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. Wichita, Kansas 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
BOXX TECHNOLOGIES, INC. Austin, Texas Workstations for computer graphics imaging and design.	15.2%	3,125,354 shares Series B Convertible Preferred Stock, convertible into 3,125,354 shares of common stock at \$0.50 per share (acquired 8-20-99 thru 8-8-01)	1,500,000	2
CMI HOLDING COMPANY, INC. Richardson, Texas Owns Chase Medical, which develops and sells devices used in cardiac surgery to relieve congestive heart failure; develops and supports cardiac imaging systems.	15.3%	10% convertible subordinated note, due 2009 (acquired 7-2-07 thru 10-9-07) 2,327,658 shares Series A Convertible Preferred Stock, convertible into 2,327,658 shares of common stock at \$1.72 per share (acquired 8-21-02 and 6-4-03) Warrants to purchase 109,012 shares of common stock at \$1.72 per share, expiring 2012 (acquired 4-7-04) 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 4,000,000 — — 6,363,347	1,000,000 2 — — 1,000,002

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
CINATRA CLEAN TECHNOLOGIES, INC. Houston, Texas 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) 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 <u>1,128,649</u> 5,391,649	\$ 4,263,000 <u>1,128,649</u> 5,391,649
DENNIS TOOL COMPANY Houston, Texas Polycrystalline diamond compacts (PDCs) used in oil field drill bits and in mining and industrial applications.	67.4%	20,725 shares 5% Convertible Preferred Stock, convertible into 20,725 shares of common stock at \$48.25 per share (acquired 8-10-98) 140,137 shares common stock (acquired 3-7-94 and 8-10-98)	999,981 <u>2,329,963</u> 3,329,944	999,981 <u>2,868,000</u> 3,867,981
† ENCORE WIRE CORPORATION McKinney, Texas 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
EXTREME INTERNATIONAL, INC. Sugar Land, Texas Owns Bill Young Productions, Texas Video and Post, and Extreme Communications, which produce radio and television commercials and corporate communications videos.	53.6%	13,035 shares Series A common stock (acquired 9-26-08 and 12-18-08) 39,359.18 shares Series C Convertible Preferred Stock, convertible into 157,436.72 shares of common stock at \$25.00 per share (acquired 9-30-03) 3,750 shares 8% Series A Convertible Preferred Stock, convertible into 15,000 shares of common stock at \$25.00 per share (acquired 9-30-03)	325,875 2,625,000 <u>375,000</u> 3,325,875	463,850 5,602,376 <u>533,774</u> 6,600,000
† HEELYS, INC. Carrollton, Texas 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
† HOLOGIC, INC. Bedford, Massachusetts 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
LIFEMARK GROUP Hayward, California Cemeteries, mausoleums and mortuaries located in northern California.	100.0%	1,449,026 shares common stock (acquired 7-16-69)	4,510,400	71,000,000

†Publicly-owned company

†Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
MEDIA RECOVERY, INC. Dallas, Texas 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) 4,000,002 shares common stock (acquired 11-4-97)	\$ 800,000 <u>4,615,000</u> 5,415,000	\$ 2,500,000 <u>12,300,000</u> 14,800,000
PALLETONE, INC. Bartow, Florida Manufacturer of wooden pallets and pressure-treated lumber.	8.5%	12.3% senior subordinated notes due 2012 (acquired 9-25-06) 150,000 shares common stock (acquired 10-18-01) Warrant to purchase 15,294 shares of common stock at \$1.00 per share, expiring 2011 (acquired 2-17-06)	1,553,150 150,000 <u>45,746</u> 1,748,896	2 2 <u>—</u> 4
† PALM HARBOR HOMES, INC. Dallas, Texas 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
THE RECTORSEAL CORPORATION Houston, Texas 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
TCI HOLDINGS, INC. Denver, Colorado Cable television systems and microwave relay systems.	—	21 shares 12% Series C Cumulative Compounding Preferred stock (acquired 1-30-90)	—	677,250
† TEXAS CAPITAL BANCSHARES, INC. Dallas, Texas Regional bank holding company with banking operations in six Texas cities.	1.6%	‡489,656 shares common stock (acquired 5-1-00)	3,550,006	5,508,630
TRAX HOLDINGS, INC. Scottsdale, Arizona 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
VIA HOLDINGS, INC. Sparks, Nevada Designer, manufacturer and distributor of high-quality office seating.	28.1%	9,118 shares Series B Preferred Stock (acquired 9-19-05) 1,118 shares Series C Preferred Stock (acquired 11-1-07)	4,559,000 <u>281,523</u> 4,840,523	2 <u>2</u> 4

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
WELLOGIX, INC. Houston, Texas 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
THE WHITMORE MANUFACTURING COMPANY Rockwall, Texas 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
MISCELLANEOUS				
	–	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
TOTAL INVESTMENTS			<u>\$89,339,191</u>	<u>\$396,635,023</u>

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Notes to Consolidated Statement of Investments

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

(b) **Unrestricted securities** (indicated by ‡) are freely marketable securities having readily available market quotations. All other securities are **restricted securities** which are subject to one or more restrictions on resale and are not freely marketable. At March 31, 2009, restricted securities represented approximately 96.5% of the value of the consolidated investment portfolio.

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

Among the factors considered by the Board of Directors in determining the fair value of restricted securities are the logic and methodology of SFAS 157, the financial condition and operating results of the issuer, the long-term potential of the business of the issuer, the market for and recent sales prices of the issuer's securities, the values of similar

securities issued by companies in similar businesses, the proportion of the issuer's securities owned by the Company, the nature and duration of resale restrictions and the nature of any rights enabling the Company to require the issuer to register restricted securities under applicable securities laws. In determining the fair value of restricted securities, the Board of Directors considers the inherent value of such securities without regard to the restrictive feature and adjusts for any diminution in value resulting from restrictions on resale. Our Board of Directors retained Duff & Phelps to provide limited scope third party valuation services on eight investments comprising 85.9% of our net asset value at March 31, 2009. Please refer to our Form 10-K for full disclosure of Duff & Phelps' services.

(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, 2009 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.	\$ 375,000
BankCap Partners Fund I, L.P.	1,309,541
CapitalSouth Partners Fund III, L.P.	130,000
Cinatra Clean Technologies, Inc.	5,391,649
Discovery Alliance, LLC	450,000
Extreme International, Inc.	325,876
Trax Holdings, Inc.	5,000,000
Miscellaneous	48,041
	<u>\$13,030,107</u>

Dispositions

	<u>Cost</u>	<u>Amount Received</u>
Ascent Media Corporation	\$ -	\$ 78,318
AT&T, Inc.	12	569,426
Comcast Corporation	21	1,109,725
Discovery Communications, Inc.	20,262	889,201
Embarq Corporation	46,532	151,182
Exopack, Inc.	-	20,252
FMC Corporation	66,727	486,097
FMC Technologies, Inc.	57,051	852,673
John Bean Technologies Corporation	-	45,360
Kimberly-Clark Corporation	2,358,518	4,349,773
Liberty Global, Inc.	207,423	1,524,611
Liberty Media Capital Group	7,833	275,117
Liberty Media Entertainment	43,996	2,531,015
Liberty Media Interactive Group	66,423	1,137,907
PETSMART, Inc.	1,318,771	6,299,194
Sprint Nextel Corporation	457,113	284,367
Sterling Group Partners I, L.P.	-	12,687
Windstream Corporation	19,656	80,742
Miscellaneous	48,043	-
	<u>\$4,718,381</u>	<u>\$20,697,647</u>

Repayments Received \$0

Capital Southwest Corporation and Subsidiaries
Consolidated Statements of Financial Condition

Assets	March 31		Liabilities and Shareholders' Equity	March 31	
	2009	2008		2009	2008
Investments at market or fair value			Other liabilities	\$ 1,187,721	\$ 1,187,796
Companies more than 25% owned			Deferred income taxes.....	<u>1,092,427</u>	<u>1,797,058</u>
(Cost: 2009 – \$29,208,246,			Total liabilities	<u>2,280,148</u>	<u>2,984,854</u>
2008 - \$28,758,246).....	\$286,488,248	\$410,026,178	Shareholders' equity		
Companies 5% to 25% owned			Common stock, \$1 par value: authorized,		
(Cost: 2009 – \$20,412,243,			5,000,000 shares; issued, 4,326,516		
2008 - \$20,412,243).....	66,388,010	54,895,381	shares at March 31, 2009 and		
Companies less than 5% owned			March 31, 2008.....	4,326,516	4,326,516
(Cost: 2009 – \$39,718,702,			Additional capital	124,571,029	115,687,153
2008 - \$31,856,977).....	<u>43,758,765</u>	<u>82,648,943</u>	Undistributed net investment income.....	2,963,640	7,036,929
Total investments			Undistributed net realized gain (loss) on		
(Cost: 2009 – \$89,339,191,			investments	42,622	(2,860,118)
2008 – \$81,027,466).....	396,635,023	547,570,502	Unrealized appreciation of investments	307,295,832	466,543,036
Cash and cash equivalents	14,721,730	31,327,758	Treasury stock – at cost 584,878 shares		
Receivables	515,212	156,322	at March 31, 2009 and 437,365 shares		
Other assets	<u>5,671,174</u>	<u>7,630,486</u>	at March 31, 2008.....	<u>(23,936,648)</u>	<u>(7,033,302)</u>
Totals	<u>\$417,543,139</u>	<u>\$586,685,068</u>	Net assets at market or fair value, equivalent		
			to \$110.98 per share at March 31, 2009 on		
			the 3,741,638 shares outstanding and		
			\$150.09 per share at March 31, 2008 on the		
			3,889,151 shares outstanding	<u>415,262,991</u>	<u>583,700,214</u>
			Totals.....	<u>\$417,543,139</u>	<u>\$586,685,068</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		
	2009	2008	2007
Investment income (see note 10):			
Interest.....	\$ 1,375,215	\$ 2,255,550	\$ 2,308,660
Dividends.....	11,533,878	3,656,833	3,954,875
Management and directors' fees.....	<u>1,076,039</u>	<u>882,300</u>	<u>708,900</u>
	<u>13,985,132</u>	<u>6,794,683</u>	<u>6,972,435</u>
Operating expenses:			
Salaries.....	2,294,187	1,619,008	1,356,062
Net pension benefit	(253,229)	(327,345)	(144,945)
Other operating expenses	<u>1,624,543</u>	<u>1,676,660</u>	<u>1,014,255</u>
	<u>3,665,501</u>	<u>2,968,323</u>	<u>2,225,372</u>
Income before interest expense and income taxes	10,319,631	3,826,360	4,747,063
Interest expense.....	-	-	460,399
Income before income taxes	10,319,631	3,826,360	4,286,664
Income tax expense	<u>136,176</u>	<u>111,160</u>	<u>53,324</u>
Net investment income	<u>\$ 10,183,455</u>	<u>\$ 3,715,200</u>	<u>\$ 4,233,340</u>
Proceeds from disposition of investments	\$ 20,697,647	\$ 1,433,891	\$ 42,919,988
Cost of investments sold.....	<u>4,718,381</u>	<u>1,193,867</u>	<u>16,872,993</u>
Realized gain on investments before income taxes	15,979,266	240,024	26,046,995
Income tax expense	<u>5,222,964</u>	-	<u>11,080,699</u>
Net realized gain on investments	<u>10,756,302</u>	<u>240,024</u>	<u>14,966,296</u>
Net increase (decrease) in unrealized appreciation of investments	<u>(159,247,203)</u>	<u>(142,969,698)</u>	<u>147,681,609</u>
Net realized and unrealized gain (loss) on investments	<u>\$(148,490,901)</u>	<u>\$(142,729,674)</u>	<u>\$162,647,905</u>
Increase (decrease) in net assets from operations	<u>\$(138,307,446)</u>	<u>\$(139,014,474)</u>	<u>\$166,881,245</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		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operations:			
Net investment income	\$ 10,183,455	\$ 3,715,200	\$ 4,233,340
Net realized gain on investments	10,756,302	240,024	14,966,296
Net increase (decrease) in unrealized appreciation of investments	<u>(159,247,203)</u>	<u>(142,969,698)</u>	<u>147,681,609</u>
Increase (decrease) in net assets from operations	(138,307,446)	(139,014,474)	166,881,245
Distributions from:			
Undistributed net investment income	(12,256,745)	(2,333,291)	(2,323,150)
Deemed distribution to shareholders	(8,646,560)	-	(11,417,283)
Capital share transactions:			
Allocated increase in share value for deemed distribution	8,646,560	-	11,417,283
Exercise of employee stock options	-	231,390	1,794,850
Adjustment to initially apply FASB No. 158, net of tax	-	-	1,173,751
Change in pension plan funded status	(1,473,329)	(1,178,764)	-
Stock option expense	503,645	263,664	169,003
Treasury stock	<u>(16,903,346)</u>	<u>-</u>	<u>-</u>
Increase (decrease) in net assets	(168,437,221)	(142,031,475)	167,695,699
Net assets, beginning of year	<u>583,700,212</u>	<u>725,731,689</u>	<u>558,035,990</u>
Net assets, end of year	<u>\$415,262,991</u>	<u>\$583,700,214</u>	<u>\$725,731,689</u>

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		
	2009	2008	2007
Cash flows from operating activities			
Increase (decrease) in net assets from operations.....	\$(138,307,446)	\$(139,014,474)	\$ 166,881,245
Adjustments to reconcile increase (decrease) in net assets from operations to net cash provided by (used in) operating activities:			
Proceeds from disposition of investments.....	20,697,647	1,433,891	42,919,988
Purchases of securities	(13,030,107)	(10,733,536)	(803,269)
Maturities of securities.....	-	154,500	884,935
Depreciation and amortization.....	40,478	32,756	16,808
Net pension benefit.....	(253,229)	(327,345)	(144,945)
Net realized gain on investments	(10,756,302)	(240,024)	(14,966,296)
Net (increase) decrease in unrealized appreciation of investments	159,247,203	142,969,698	(147,681,609)
Stock option expense	503,645	263,664	169,003
(Increase) decrease in receivables	(358,890)	181,570	(202,005)
Increase in other assets	(33,358)	(80,195)	(39,982)
Increase (decrease) in other liabilities.....	7,620	(33,281)	8,934
Decrease in accrued pension liability	(68,934)	(135,768)	(144,171)
Increase in deferred income taxes	<u>88,700</u>	<u>114,000</u>	<u>50,700</u>
Net cash provided by (used in) operating activities	<u>17,777,027</u>	<u>(5,414,544)</u>	<u>46,949,336</u>
Cash flows from financing activities			
Decrease in note payable to bank	-	-	(8,000,000)
Distributions from undistributed net investment income	(12,256,745)	(2,333,291)	(2,323,150)
Proceeds from exercise of employee stock options	-	231,390	1,794,850
Purchase of treasury stock.....	(16,903,346)	-	-
Payment of federal income tax for deemed capital gains distribution	<u>(5,222,964)</u>	<u>-</u>	<u>(11,080,699)</u>
Net cash used in financing activities	<u>(34,383,055)</u>	<u>(2,101,901)</u>	<u>(19,608,999)</u>
Net increase (decrease) in cash and cash equivalents	(16,606,028)	(7,516,445)	27,340,337
Cash and cash equivalents at beginning of year	<u>31,327,758</u>	<u>38,844,203</u>	<u>11,503,866</u>
Cash and cash equivalents at end of year.....	<u>\$ 14,721,730</u>	<u>\$ 31,327,758</u>	<u>\$ 38,844,203</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for: Interest.....	\$ -	\$ -	\$ 460,399
Income taxes	\$ 3,576	\$ -	\$ 20,000

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

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

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

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

Fair Value Measurements. The Company adopted SFAS No. 157, *Fair Value Measurements* (“SFAS 157”), on April 1, 2008. SFAS 157 (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 the Company’s notes to the financial statements. Additionally, SFAS 157 does not eliminate practicability exceptions that exist in accounting pronouncements amended by this Statement when measuring fair value. As a result, the Company will not be required to recognize any new assets or liabilities at fair value.

Prior to SFAS 157, 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). SFAS 157 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. In measuring fair value, the Company may make adjustments for risks and uncertainties, if a market participant would include such an adjustment in its pricing.

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

Investments. Investments are stated at market or fair value determined by the Board of Directors as described in the Notes to Portfolio of Investments and Note 2 below. The average cost method

is used in determining cost of investments sold. Investments are recorded on a trade date basis. Dividends are recognized on the ex-dividend date and interest income is accrued daily.

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

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

Federal Income Taxes. CSC and CSVC intend to comply with the requirements of the Internal Revenue Code (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. The Company's policy is to retain and pay the 35% corporate tax on realized long-term capital gains. For investment companies that qualify as RICs under the IRC, federal income taxes payable on security gains that the company elects to retain are accrued only on the last day of the tax year, December 31. Therefore, CSC and CSVC made no provision for federal income taxes on such gains and net investment income in their financial statements.

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

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48 ("FIN 48"), which clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement 109, "Accounting for

Income Taxes". FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company adopted FIN 48 on April 1, 2007, which had no effect on the Company's financial statements.

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

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

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

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

ended March 31, 2009 and March 31, 2008, the Company recognized compensation expense of \$503,645 and \$263,664, respectively.

As of March 31, 2009, the total remaining unrecognized compensation cost related to non-vested stock options was \$2,362,927 which will be amortized over the weighted-average service period of approximately 4.69 years.

Defined Pension Benefits and Other Postretirement Plans

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

- Recognize the funded status of postretirement defined benefit plans – measured as the difference between the fair value of plan assets and the benefit obligations – in its balance sheet.
- Recognize changes in the funded status of postretirement defined benefit plans in shareholder's equity in the year in which the changes occur.
- 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, 2009, the Company's money market account balances exceeded the Federal Deposit Insurance Corporation's limits by \$13.8 million.

Recent Accounting Pronouncements

The Company adopted FASB Statement No. 157, *"Fair Value Measurements"* ("SFAS 157"), on a prospective basis on April 1, 2008. SFAS 157 requires that the Company assume that the portfolio investment is to be sold in a principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market.

In October 2008, FASB Staff Position 157-3, *"Determining the Fair Value of a Financial Asset When the Market for that Asset is not Active"* ("FSP 157-3") was issued. FSP 157-3 reiterated that an entity should utilize its own assumptions, information and techniques to estimate fair value when relevant observable inputs are not available, including the use of risk-adjusted factors for non-performance risk or liquidity risk.

In April 2009, the FASB issued FASB Staff Position FAS 157-4, *"Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly"* ("FSP 157-4"). FSP 157-4 indicates that if an entity determines that either the volume and/or level of activity for an asset or liability has significantly decreased (from normal conditions for that asset or liability) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. FSP 157-4 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted. FSP 157-4 must be applied prospectively. The Company does not believe the adoption of FSP 157-4 will have a material impact on the consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments" ("FSP 107-1"). FSP 107-1 relates to fair value disclosures in public entity financial statements for financial instruments that are within the scope of Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments" ("SFAS 107"). This guidance increases the frequency of those disclosures, requiring public entities to provide the disclosures on a quarterly basis (rather than just annually). The quarterly disclosures are intended to provide financial statement users with more timely information about the effects of current market conditions on an entity's financial instruments that are not otherwise reported at fair value. FSP 107-1 is effective for interim and annual periods ending after June 15, 2009. FSP 107-1 must be applied prospectively. The Company does not believe the adoption of FSP 107-1 will have a material impact on the consolidated financial statements.

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 SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). Where inputs for an asset or liability fall in more than one level in the fair value hierarchy, the investment is classified in its entirety based on the lowest level input that is significant to that investment's fair value measurement. 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:* Level 1 inputs are 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 over-the-counter (NASDAQ) securities on the valuation date.
- *Level 2:* Level 2 inputs are inputs 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, 2009.
- *Level 3:* Level 3 inputs are unobservable and cannot be corroborated by observable market data. We use Level 3 inputs for measuring the fair value of substantially all of our investments. See "Notes to Portfolio of Investments" (c) on page 12 for the investment policy used to determine the fair value of these investments.

The following fair value hierarchy table sets forth our investment portfolio by level as of March 31, 2009 (in millions):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Debt	\$ -	\$ -	\$ 8.3	\$ 8.3
Partnership Interests	-	-	6.7	6.7
Preferred Equity	-	-	15.8	15.8
Common Equity	13.8	-	352.1	365.9
Equity Warrants	-	-	-	-
Total Investments	<u>\$13.8</u>	<u>\$ -</u>	<u>\$382.9</u>	<u>\$396.7</u>

The following table sets forth a summary of changes in the fair value of investment assets and liabilities measured using Level 3 inputs during the quarter ended March 31, 2009 (in millions):

	Beginning Balance	Unrealized gain (loss)	Purchases Sales, Issuance & Settlement	Ending Balance
Debt	\$ 9.2	\$ (0.9)	\$ -	\$ 8.3
Partnership Interests	6.8	(0.4)	0.3	6.7
Preferred Equity	17.0	(2.2)	1.0	15.8
Common Equity	<u>408.4</u>	<u>(56.3)</u>	<u>-</u>	<u>352.1</u>
Total Investments	<u>\$441.4</u>	<u>\$(59.8)</u>	<u>\$1.3</u>	<u>\$382.9</u>

The following table sets forth a summary of changes in the fair value of investment assets and liabilities measured using Level 3 inputs during the year ended March 31, 2009 (in millions):

	Beginning Balance	Unrealized gain (loss)	Purchases Sales, Issuance & Settlement	Ending Balance
Debt	\$ 9.0	\$ (5.0)	\$ 4.3	\$ 8.3
Partnership Interests	5.3	(0.9)	2.3	6.7
Preferred Equity	21.8	(12.2)	6.1	15.8
Common Equity	458.3	(106.5)	0.3	352.1
Equity Warrants	<u>0.4</u>	<u>(0.4)</u>	<u>-</u>	<u>-</u>
Total Investments	<u>\$494.8</u>	<u>\$(124.9)</u>	<u>\$13.0</u>	<u>\$382.9</u>

3. Income Taxes

CSC and CSVC operate to qualify as a RIC under Subchapter M of the Code. 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 distributed or intend to distribute sufficient dividends to eliminate taxable income for our completed tax fiscal years. If we fail to satisfy the 90% distribu-

tion 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, 2008 and 2007, 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.

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.

As permitted by the IRC, a RIC can designate dividends paid in the subsequent tax year as dividends of the current year ordinary taxable income and long-term capital gains if those dividends are both declared by the extended due date of the RIC's federal income tax return and paid to shareholders by the last day of the subsequent tax year. For the tax years ended December 31, 2008 and 2007 we declared and paid dividends in the amounts of \$12,256,745 and \$2,333,291, 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, 2008 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, 2008. For the tax year ended De-

December 31, 2007, we distributed 100% of our investment company ordinary taxable income, however only 70% was distributed by the end of the tax year. As a result, we incurred an excise tax of 4% of the undistributed income or \$41,543, which was paid in 2008 and is included in income tax expense on the accompanying consolidated statements of operation.

CSC, 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."

For the tax year ended December 31, 2008, we have estimated 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. For the tax year ended December 31, 2007, we had net long-term capital losses of \$944,872 for tax purposes and \$860,118 for book purposes, which we carried forward and offset by future net long-term capital gains. In order to make the election to retain capital gains, we incurred a federal tax on behalf of our shareholders of \$5,222,964 for the tax year ended De-

December 31, 2008. As of December 31, 2008, we did not have any undistributed long-term capital gains since they are treated as being distributed through the "deemed distribution."

As of March 31, 2009 and 2008, our undistributed net realized gains (losses) on investments determined in accordance with GAAP as reflected on our consolidated statement of financial condition were comprised of the following:

As of March 31,	2009	2008
Undistributed net realized gains (losses) on investments	\$42,622	(\$2,860,118)

5. Share Repurchase Plan

On June 12, 2008, CSC announced that its Board of Directors authorized a share repurchase plan, which allowed for the repurchase of up to 10% (or 388,915 shares) of its Common Stock at prices not above the lower of the net asset value per share of its Common Stock, or prices prevailing in the over-the-counter market at the time of such purchases. The repurchase program remained in effect through December 10, 2008. CSC did not make purchases under the plan during the quarter ended March 31, 2009. In total CSC purchased 147,513 shares of Common Stock for \$16,903,346 at an average price of \$114.59 per share, on the open market, while the plan was in effect.

6. Employee Stock Option Plan

On July 19, 1999, shareholders approved the 1999 Stock Option Plan ("Plan"), which provides for the granting of stock options to employees and officers of the Company and authorizes the issuance of common stock upon exercise of such options for up to 140,000 shares. All options are granted at or above market price, generally expire 10 years from the date of grant and are generally exercisable on or after the first anniversary of the date of grant in 5 to 10 annual installments.

At March 31, 2009, there were no shares available for grant under the Plan. The following table summarizes the 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)
May 15, 2006	\$31.28	0.64%	5.08%	21.1%	7
July 17, 2006	\$33.05	0.61%	5.04%	21.2%	7
July 16, 2007	\$41.78	0.39%	4.95%	19.9%	5
July 21, 2008	\$27.35	0.67%	3.41%	20.2%	5
July 30, 2008	\$29.93	0.62%	3.36%	20.2%	5

The following summarizes activity in the stock option plans for the years ended March 31, 2009, 2008 and 2007:

	Number of shares	Weighted Average Exercise Price
Balance at March 31, 2007	52,500	\$ 68.411
Granted	25,000	94.136
Exercised	(3,100)	69.568
Canceled	<u>(4,000)</u>	<u>89.482</u>
Balance at March 31, 2008	70,400	109.998
Granted	37,500	123.721
Exercised	-	-
Canceled	<u>-</u>	<u>-</u>
Balance at March 31, 2009	<u>107,900</u>	<u>\$114.767</u>

	Weighted Average Aggregate Intrinsic	
	Remaining Contractual Term	Value
March 31, 2009		
Outstanding	4.7 years	\$3,255,618
Exercisable	4.4 years	\$ 608,339

At March 31, 2009, the range of exercise prices and weighted-average remaining contractual life of outstanding options was \$65.00 to \$152.98 and 4.69 years, respectively. There were no options exercised during the year ended March 31, 2009. The total intrinsic value

of options exercised during the years ended March 31, 2008 and 2007 were \$75,129 and \$571,565, respectively. The exercise prices ranged from \$65.00 to \$93.49 per share for the each of the years ended March 31, 2008 and 2007. New shares were issued for, \$0, \$231,390 and \$1,794,850 cash received from option exercises for the years ended March 31, 2009, 2008 and 2007, respectively.

At March 31, 2009, 2008 and 2007, the number of options exercisable was 21,445, 9,930 and 8,515, respectively and the weighted-average exercise price of those options was \$97.00, \$79.01 and \$69.15, respectively.

7. 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, 2009, the Company made contributions to the ESOP, which were charged against net investment income, of \$0 in 2009, \$94,210 in 2008 and \$84,488 in 2007.

8. 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, 2009.

The following tables set forth the qualified plan's benefit obligations and fair value of plan assets at March 31, 2009, 2008 and 2007:

	Years Ended March 31		
	2009	2008	2007
Change in benefit obligation			
Benefit obligation at beginning of year	\$3,699,285	\$3,965,100	\$4,004,017
Service cost	67,340	67,514	103,342
Interest cost	290,310	222,895	230,711
Actuarial loss	(916,874)	(160,840)	68,854
Benefits paid	(259,810)	(395,384)	(386,982)
Plan change	34,262	-	(54,842)
Benefit obligation at end of year	<u>\$2,914,513</u>	<u>\$3,699,285</u>	<u>\$3,965,100</u>
Change in plan assets			
Fair value of plan assets at beginning of year	\$11,120,337	\$12,973,292	\$11,640,693
Actual return on plan assets	(2,477,154)	(1,457,571)	1,719,581
Benefits paid	(259,810)	(395,384)	(386,982)
Fair value of plan assets at end of year	<u>\$ 8,383,373</u>	<u>\$11,120,337</u>	<u>\$12,973,292</u>

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

	March 31	
	2009	2008
Actuarial present value of benefit obligations:		
Accumulated benefit obligation	<u>\$(2,630,743)</u>	<u>\$(3,387,397)</u>
Projected benefit obligation for service rendered to date	\$(2,914,513)	\$(3,699,285)
Plan assets at fair value*	<u>8,383,373</u>	<u>11,120,337</u>
Funded status	5,468,860	7,421,052
Unrecognized net (gain) loss from past experience different from that assumed and effects of changes in assumptions	2,502,161	209,044
Unrecognized prior service costs	159,716	129,179
Additional asset, FAS 158	<u>(2,661,877)</u>	<u>(338,223)</u>
Prepaid pension cost included in other assets	<u>\$ 5,468,860</u>	<u>\$ 7,421,052</u>

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

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

	Years Ended March 31		
	2009	2008	2007
Service cost – benefits earned during the year	\$ 67,340	\$ 67,514	\$ 103,342
Interest cost on projected benefit obligation	290,310	222,895	230,711
Expected return on assets	(732,837)	(673,366)	(580,104)
Net amortization	<u>3,725</u>	<u>3,725</u>	<u>27,487</u>
Net pension benefit from qualified plan	<u>\$(371,462)</u>	<u>\$(379,232)</u>	<u>\$(218,564)</u>

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

The following table sets forth the Retirement Restoration Plan's benefit obligations at March 31, 2009, 2008 and 2007:

	Years Ended March 31		
	2009	2008	2007
Change in benefit obligation			
Benefit obligation at beginning of year	\$942,122	\$1,178,891	\$1,280,542
Service cost	10,986	10,483	20,245
Interest cost	104,777	57,588	68,937
Actuarial (gain) loss	(74,613)	(169,072)	(36,529)
Benefits paid	(68,934)	(135,768)	(144,170)
Plan change	<u>20,089</u>	<u>-</u>	<u>(10,134)</u>
Benefit obligation at end of year	<u>\$934,427</u>	<u>\$ 942,122</u>	<u>\$1,178,891</u>

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

	March 31	
	2009	2008
Projected benefit obligation.....	\$(934,427)	\$(942,122)
Unrecognized net loss from past experience different from that assumed and effects of changes in assumptions	(431,432)	(112,552)
Unrecognized prior service costs	(187,280)	(217,958)
Additional asset, FAS 158	<u>618,712</u>	<u>330,510</u>
Accrued pension cost included in other liabilities.....	<u>\$(934,427)</u>	<u>\$(942,122)</u>

Components of net pension expense related to the unfunded Retirement Restoration Plan include the following:

	Years Ended March 31		
	2009	2008	2007
Service cost – benefits earned during the year.....	\$ 10,986	\$ 10,483	\$ 20,245
Interest cost on projected benefit obligation.....	104,777	57,588	68,937
Net amortization	<u>2,470</u>	<u>(16,186)</u>	<u>(15,563)</u>
Net pension expense from retirement restoration plan.....	<u>\$118,233</u>	<u>\$ 51,885</u>	<u>\$ 73,619</u>

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

	Years Ended March 31		
	2009	2008	2007
Discount rate	6.50%	6.25%	6.0%
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		
	2009	2008	2007
Discount rate	6.25%	6.0%	5.75%
Expected return on plan assets	6.5%	6.5%	6.0%
Rate of compensation increases.....	5.0%	5.0%	5.0%

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

CSC's pension plan asset allocations are as follows:

Asset Category	Percentage of plan assets at March 31	
	2009	2008
Equity securities	67.7%	75.0%
Debt securities	19.2%	13.8%
Other.....	<u>13.1%</u>	<u>11.2%</u>
	<u>100.0%</u>	<u>100.0%</u>

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 are managed by the committee, invested mostly in equity securities, including CSC stock.

Following are the expected benefit payments for the next five years and in the aggregate for the years 2015-2019:

(In Thousands)	Years Ended March 31					2015-
	2010	2011	2012	2013	2014	2019
Qualified Plan	\$85	\$81	\$226	\$219	\$211	\$1,092
Restoration Plan	-	-	\$95	\$93	\$92	\$432

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

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

9. Commitments

CSC has agreed, subject to certain conditions, to invest up to \$8,683,070 in six portfolio companies.

The Company leases office space under an operating lease which requires base annual rentals of approximately \$87,000 through February, 2013. For the three years ended March 31, total rental expense charged to investment income was \$84,117 in 2009, \$80,569 in 2008 and \$79,979 in 2007.

10. Sources of Income

Income was derived from the following sources:

Years Ended <u>March 31</u> 2009	Investment Income			Realized Gain (Loss) on Investments Before Income Taxes
	Interest	Dividends	Other Income	
Companies more than 25% owned.....	\$ —	\$10,946,581	\$1,055,000	\$ —
Companies 5% to 25% owned	249,417	326,940	20,750	—
Companies less than 5% owned.....	743,945	260,357	—	15,979,266
Other sources, including temporary investments	382,142	—	—	—
	<u>\$1,375,504</u>	<u>\$11,533,878</u>	<u>\$1,075,750</u>	<u>\$15,979,266</u>

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

Years Ended <u>March 31</u> 2007	Investment Income			Realized Gain (Loss) on Investments Before Income Taxes
	Interest	Dividends	Other Income	
Companies more than 25% owned.....	\$ —	\$3,449,558	\$659,500	\$31,070,149
Companies 5% to 25% owned	125,733	171,578	20,000	—
Companies less than 5% owned.....	938,761	333,739	29,400	(5,023,154)
Other sources, including temporary investments	<u>1,244,166</u>	—	—	—
	<u>\$2,308,660</u>	<u>\$3,954,875</u>	<u>\$708,900</u>	<u>\$26,046,995</u>

Selected Per Share Data and Ratios

	Years Ended March				
	2009	2008	2007	2006	2005
Per Share Data					
Investment income	\$ 3.74	\$ 1.75	\$ 1.79	\$ 1.25	\$ 1.26
Operating expenses	(.98)	(.76)	(.57)	(.51)	(.51)
Interest expense	-	-	(.12)	(.11)	(.11)
Income taxes	(.04)	(.03)	(.01)	(.01)	(.02)
Net investment income	2.72	.96	1.09	.62	.62
Distributions from undistributed net investment income	(3.28)	(.60)	(.60)	(.60)	(.60)
Net realized gain (loss) on investments	2.87	.06	3.85	4.00	(2.62)
Net increase (decrease) in unrealized appreciation of investments	(42.56)	(36.76)	38.00	32.22	7.21
Treasury stock repurchase *					
Exercise of employee stock options **	-	(.09)	(.49)	(.04)	-
Stock option expense .....	.13	.07	.04	-	-
Net change in pension plan funded status	(.39)	(.30)	-	-	-
Treasury Stock	1.40	-	-	-	-
Adjustment to initially apply FASB No. 158, net of tax	-	-	.30	-	-
Increase (decrease) in net asset value	(39.11)	(36.66)	42.19	36.20	4.61
Net asset value					
Beginning of year	150.09	186.75	144.56	108.36	103.75
End of year	<u>\$110.98</u>	<u>\$150.09</u>	<u>\$186.75</u>	<u>\$144.56</u>	<u>\$108.36</u>
Ratios and Supplemental Data					
Ratio of operating expenses to average net assets .....	.71%	.46%	.36%	.42%	.49%
Ratio of net investment income to average net assets	1.96%	.58%	.68%	.51%	.60%
Portfolio turnover rate	2.51%	.22%	.13%	2.36%	.56%
Net asset value total return	(22.56)%	(19.27)%	29.85%	34.31%	5.25%
Shares outstanding at end of period (000s omitted)	3,741	3,889	3,886	3,860	3,857

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

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

CSC has assessed the effectiveness of its internal control over financial reporting as of March 31, 2009. In making this assessment, it used the criteria described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management believes that, as of March 31, 2009, CSC's internal control over financial reporting was effective.

During the fiscal quarter ended March 31, 2008, CSC implemented the following control in order to remediate the material weakness we identified in our internal controls over accounting for taxes, which resulted in the restatement of our consolidated financial statements for the

year ended March 31, 2007 and years represented in our Form 10-K for the year ended March 31, 2007.

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

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

Grant Thornton LLP, the independent registered public accounting firm that audited our consolidated financial statements included in this annual report on Form 10-K for the year ended March 31, 2009, has issued an attestation report on our internal control over financial reporting as of March 31, 2009. That report appears on the next page.

Date: May 29, 2009

/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, 2009, 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, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial condition of the Company as of March 31, 2009 and 2008, including the portfolio of investments as of March 31, 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, 2009, and the selected per share data and ratios for each of the five years in the period ended March 31, 2009, and our report dated May 29, 2009, expressed an unqualified opinion.

/s/Grant Thornton LLP
Dallas, Texas
May 29, 2009

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Capital Southwest Corporation

We have audited the accompanying consolidated statements of financial condition of Capital Southwest Corporation (a Texas Corporation) and subsidiaries (the "Company") as of March 31, 2009 and 2008, including the portfolio of investments as of March 31, 2009, and the related consolidated statements of operations, changes in net assets, cash flows for each of the three years in the period ended March 31, 2009, and the selected per share data and ratios for each of the five years in the period ended March 31, 2009. These financial statements and per share data and ratios are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and per share data and ratios based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements 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, 2009 and 2008, 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 ma-

terial respects, the consolidated financial position of Capital Southwest Corporation and subsidiaries as of March 31, 2009 and 2008, and the consolidated results of its operations, changes in its net assets, its cash flows for each of the three years in the period ended March 31, 2009, and the selected per share data and ratios for each of the five years in the period ended March 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2 to the consolidated financial statements, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, ("SFAS 157"), effective April 1, 2008. As described in Note 8 to the consolidated financial statements, the Company also adopted the provisions of FASB Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans: An Amendment of FASB Statements No. 87, 88, 106, and 132(R)*, effective March 31, 2007.

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, 2009, 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 29, 2009, expressed an unqualified opinion thereon.

/s/Grant Thornton LLP

Dallas, Texas
May 29, 2009

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 \$381,498 in 2009, \$1,421,048 in 2008 and \$1,187,676 in 2007. The Company also receives management fees primarily from its controlled affiliates which aggregated \$984,800 in 2009, \$784,800 in 2008 and \$626,400 in 2007. During the three years ended March 31, 2009, the Company recorded dividend income from the following sources:

	Years Ended March 31		
	2009	2008	2007
Alamo Group Inc.	\$ 679,272	\$ 678,732	\$ 677,112
Balco, Inc.....	-	224,400	-
Dennis Tool Company	49,999	62,499	62,499
Encore Wire Corporation.....	326,940	326,940	-
Heelys, Inc.....	9,317,310	-	-
Kimberly-Clark Corporation	89,529	167,481	154,360
Lifemark Group.....	-	571,333	600,000
PalletOne, Inc.	-	-	89,842
The RectorSeal Corporation	720,000	1,154,133	1,869,947
Sprint Nextel Corporation	-	6,750	9,000
TCI Holdings, Inc.....	81,270	81,270	81,270
The Whitmore Manufacturing Company	180,000	288,533	240,000
Other.....	<u>89,558</u>	<u>94,762</u>	<u>170,845</u>
	<u>\$11,533,878</u>	<u>\$3,656,833</u>	<u>\$3,954,875</u>

Total operating expenses, excluding interest expense, 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 \$10,756,303 (after income tax expense of \$5,222,963) during the year ended March 31, 2009, compared with a gain of \$240,024 during 2008 and a gain of \$14,966,296 (after income tax expense of \$11,080,699) during 2007. 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 a decrease in unrealized appreciation of investments of \$159,247,203, in 2009 and a decrease of \$142,969,698, in 2008 and an increase of \$147,681,609 in 2007. 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		
	2009	2008	2007
Alamo Group Inc.	\$(22,642,400)	\$ (2,803,090)	\$ 2,821,000
Encore Wire Corporation.....	14,303,625	(18,390,625)	(12,260,000)
Heelys, Inc.....	(20,963,948)	(160,724,088)	170,040,908
The Whitmore Manufacturing Company.....	(2,000,000)	12,000,000	4,000,000
Lifemark Group.....	-	31,000,000	(2,000,000)
Media Recovery, Inc.	(22,700,000)	(7,500,000)	3,000,000
Palm Harbor Homes, Inc.....	(21,601,583)	(39,275,516)	(27,493,000)
The RectorSeal Corporation	(37,000,000)	46,200,000	10,500,000

As shown in the table for the year ended March 31, 2009, we sustained major decreases in several of our largest investments. During the twelve months ended March 31, 2009, the value of our investments in The RectorSeal Corporation decreased by \$37,000,000 and Media Recovery, Inc. decreased by \$22,700,000, due to decreases in their respective sales resulting from slowdowns in segments of their businesses. Additionally, our investments in Alamo Group, Inc. decreased \$22,642,400, Palm Harbor Homes, Inc. decreased \$21,601,583, and Heelys, Inc. decreased \$20,963,948, due primarily to the decreases in their respective stock prices at March 31, 2009. Offsetting the aforementioned losses during the twelve months ended March 31, 2009, was a \$14,030,625 increase in the value of Encore Wire Corporation due primarily to an increase in their stock price at March 31, 2009.

A description of the investments listed above and other material components of the investment portfolio is included elsewhere in this report under the caption "Portfolio of Investments – March 31, 2009."

Portfolio Investments

During the year ended March 31, 2009, the Company invested \$13,030,107 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 2008 and 2007 fiscal years, the Company invested a total of \$10,733,536 and \$803,269, respectively.

Financial Liquidity and Capital Resources

At March 31, 2009, the Company had cash and cash equivalents of approximately \$14.7 million. Pursuant to Small Business Administration (SBA) regulations, cash and cash equivalents of \$5.3 million held by CSVC may not be transferred or advanced to CSC without the consent of the SBA. Under current SBA regulations and subject to the

SBA's approval of its credit application, CSVC would be entitled to borrow up to \$20.6 million.

With the exception of a capital gain distribution made in the form of a distribution of the stock of a portfolio company in the fiscal year ended March 31, 1996, the Company has elected to retain all gains realized during the past 40 years. Retention of future gains is viewed as an important source of funds to sustain the Company's investment activity. Approximately \$13.8 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, 2009. For further information see Note 9 of the Consolidated Financial Statements.

Contractual Obligations	Payments Due By Period (\$ in Thousands)			
	Total	1 Year	2-4 Years	More Than 4 Years
Operating lease obligations	\$340	\$87	\$253	-
Total	\$340	\$87	\$253	-

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)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Financial Position (as of March 31)										
Investments at cost	\$ 85,002	\$ 87,602	\$ 82,194	\$ 91,462	\$ 97,283	\$ 84,546	\$ 88,597	\$ 71,642	\$ 81,027	\$ 89,339
Unrealized appreciation.....	<u>238,627</u>	<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>
Investments at market or fair value	323,629	315,918	347,481	287,060	406,949	422,022	550,428	681,155	547,571	396,635
Total assets	392,586	322,668	357,183	298,490	423,979	434,384	569,368	729,507	586,685	417,543
Notes payable *	10,000	16,000	14,000	23,000	20,500	13,000	8,000	-	-	-
Net assets.....	319,438	303,436	339,891	272,211	400,157	417,947	558,036	725,732	583,700	415,263
Shares outstanding	3,815	3,815	3,829	3,829	3,857	3,857	3,860	3,886	3,889	3,741
Changes in Net Assets (years ended March 31)										
Net investment income.....	\$ 1,663	\$ 1,723	\$ 2,042	\$ 2,299	\$ 2,587	\$ 2,406	\$ 2,389	\$ 4,233	\$ 3,715	\$ 10,183
Net realized gain (loss) on investments	5,162	(5,126)	(762)	2,007	12,603	(10,112)	15,451	14,966	240	10,756
Net increase (decrease) in unrealized appreciation before distributions	<u>(38,072)</u>	<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>
Increase (decrease) in net assets from operations before distributions	(31,247)	(13,714)	38,251	(65,383)	129,258	20,104	142,195	166,881	(139,014)	(138,307)
Cash dividends paid	(2,289)	(2,289)	(2,295)	(2,297)	(2,309)	(2,314)	(2,314)	(2,323)	(2,333)	(12,257)
Employee stock options exercised	-	-	499	-	997	-	208	1,795	231	-
Stock option expense	-	-	-	-	-	-	-	169	263	503
Change in pension plan funded status	-	-	-	-	-	-	-	-	(1,178)	(1,473)
Treasury stock	-	-	-	-	-	-	-	-	-	(16,903)
Adjustment to initially apply FASB Statement No. 158, net of tax .	-	-	-	-	-	-	-	1,173	-	-
Increase (decrease) in net assets	<u>(33,536)</u>	<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>
Per Share Data (as of March 31)										
Net assets.....	\$ 83.73	\$ 79.54	\$ 88.77	\$ 71.09	\$ 103.75	\$ 108.36	\$ 144.56	\$ 186.75	\$ 150.09	\$ 110.98
Closing market price.....	54.75	65.00	68.75	48.15	75.47	79.10	95.50	153.67	123.72	76.39
Cash dividends paid .....	.60	.60	.60	.60	.60	.60	.60	.60	.60	3.26

- 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, 2009. 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:

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

<u>Quarter Ended</u>	<u>High</u>	<u>Low</u>
June 30, 2007.....	\$190.33	\$144.50
September 30, 2007.....	162.13	110.00
December 31, 2007.....	130.00	105.16
March 31, 2008.....	127.49	100.00

Dividends

The payment dates and amounts of cash dividends per share since

April 1, 2007 are as follows:

<u>Payment Date</u>	<u>Cash Dividend</u>
May 31, 2007.....	\$0.20
November 30, 2007.....	0.40
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

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 20, 2009, at 10:00 a.m. in the North Dallas Bank Tower Meeting Room (second floor), 12900 Preston Road, Dallas, Texas.

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, 2008

Capital Southwest Corporation ("CSC") elected to retain the taxable net long-term capital gains realized during its taxable year ended December 31, 2008, and pay the applicable Federal income tax, as shown below on a per share basis.

Net long-term capital gains retained	\$3.9883 per share
Federal income tax paid	\$1.3959 per share

In accordance with the Internal Revenue Code, shareholders of record on December 31, 2008 were required to include their pro rata portion (\$3.9883 per share) of these gains on Schedule D of their 2008 Federal tax returns and are entitled to a credit for, or a refund of, their pro rata portion (\$1.3959 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 \$2.5924 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, 2008 setting forth the specific amounts to be included in each shareholder's 2008 tax return. This form was accompanied by a detailed instruction letter entitled "Important Tax Information" dated January 30, 2009, 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 \$1.3959 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 2008 tax benefits.

For Shareholders from 1968 through 2008

In certain years from 1968 through 2008, 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 capital gains per share</u>	<u>Federal income taxes paid per share</u>	<u>Increase in tax basis 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

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 and is a Certified Public Accountant.

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.

Jeffrey G. Peterson, Vice President, Chief Compliance Officer, Corporate Secretary and Valuation Manager, joined Capital Southwest in 2001. Previously, he was employed in the investment banking de-

partments of UBS Warburg and Scott & Stringfellow, Inc. and in the credit department of Bank One Corporation. He is President of the Southern Regional Association of Small Business Investment Companies (SORASBIC) and serves on the Board of Governors of the National Association of Small Business Investment Companies (NASBIC), the Education Committee of the Venture Capital Institute and the Steering Committee for the Dallas-Fort Worth Private Equity Forum. He received an MBA with distinction from the Johnson Graduate School of Management at Cornell University and a BBA from the University of Texas at Austin.

Tracy L. Morris, Chief Financial Officer, 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.