

## To Our Shareholders

After consideration of the appropriate accounting treatment for taxes and extensive discussions with regulatory authorities and independent accountants, our Board of Directors has determined that Capital Southwest Corporation will discontinue its long-standing policies of accruing deferred taxes on its unrealized gains, and accruing taxes on its investment gains in periods other than the last day of its tax year, December 31. Additionally the Company will begin appropriately treating our retained gains on investments as net realized gains deemed distributed to shareholders and classify them as an increase to "additional capital" at each tax year end. Undistributed amounts remaining since the Company's previous tax year end, adjusted for tax differences, will be classified as "undistributed net realized gains on investments".

As a result, net asset value at September 30, 2007 was \$606,872,698, equivalent to \$156.04 per share. Using our previous accounting treatment, net asset value would have been \$437,546,529, equivalent to \$112.50 per share after deducting tax adjustments of \$169,326,169 or \$43.54 per share.

In conformity with generally accepted accounting principles, we have amended and restated consolidated financial statements for each of the fiscal years ended March 31, 2007, 2006 and 2005 and selected per share data and ratios for the years ended March 31, 2004 and 2003. In addition, we have filed an amendment to our report for the quarter ended June 30, 2007. In all restatements, the net asset value previously reported has been increased by the estimated deferred taxes on tax adjustments as shown below on a per share basis:

<u>Date</u>	<u>Reported</u>		<u>Restated</u>
	<u>Net Asset Value</u>	<u>Tax Adjustments</u>	<u>Net Asset Value</u>
March 31, 2003	\$53.92	\$17.17	\$71.09
March 31, 2004	75.35	28.40	103.75
March 31, 2005	78.44	29.90	108.36
March 31, 2006	102.74	41.82	144.56
March 31, 2007	132.36	54.40	186.75
June 30, 2007	135.21	55.93	191.13

Assuming reinvestment of all dividends and tax credits on retained long-term capital gains, our restated September 30, 2007 net asset

value increased by 10.6% during the past twelve months, but decreased by 16.4% during the first half of the current fiscal year.

During the six months ended September 30, 2007, unrealized appreciation of investments decreased by \$120,980,544. This change included increases of \$38,604,116, which was more than offset by decreases in unrealized appreciation of \$159,584,660. The largest single component of the decrease was \$139,760,000, attributable to our investment in Heelys, Inc., the stealth skate shoe company which became a publicly-owned company on December 8, 2006. The Heelys investment represented our largest holding at March 31, 2007, when the market had propelled the aggregate value to \$195,664,000. Unfortunately, the market for Heelys' stock subsequently declined to a level that collapsed the value of our investment to \$55,904,000 at September 30, 2007.

How could this investment in the innovative company that invented the stealth skate footwear for kids have such a dramatic change in value? A simple answer involves overstocked retailers. A more complex answer entails the aftermath of supply/demand imbalances within a finicky retail market that was dependent on overseas sourcing. The managers at Heelys are working to restore normality to the company's supply chain and position unique new products for future introductions. The Heelys' management certainly understands that the company's public market value will reflect their progress in restoring growth by introducing new products and successfully serving their existing and new customers.

In addition to Heelys, major sources of the decline in our unrealized appreciation of investments for the six months ended September 30, 2007 included a \$9,000,000 decrease in the value of Media Recovery, Inc. and a \$7,855,000 decrease in the value of Palm Harbor Homes, Inc. During the same period, unrealized appreciation reflected a \$10,850,000 increase in the value of The RectorSeal Corporation, a \$6,130,000 increase in the value of Encore Wire Corporation and a \$5,600,000 increase in the value of All Components, Inc.

Our directors value the entire portfolio each quarter. Valuing freely marketable shares of actively traded companies such as Kimberly-Clark is a straightforward mathematical exercise. Valuing the restricted securities of smaller, emerging issuers is much more compli-

cated. From time to time, we receive inquiries from investors and the general public regarding discounts applied by our directors to the public market prices of our investments in the restricted stocks of several publicly traded companies in our portfolio. The valuation of each such security reflects its public market price discounted to an appropriate level in view of applicable resale restrictions and fundamental factors influencing the potential of each company. The extreme decline in Heelys' value between March 31 and September 30, 2007 illustrates the combined effect of a market price collapse and a pronounced change in fundamental factors.

As stated in our shareholder reports, our restricted securities which are not freely marketable, are valued at amounts "which the Company may reasonably expect to receive if such securities were sold on the valuation date". In accordance with the Investment Company Act of 1940, the fair values of such securities are to be "determined in good faith by the board of directors". The valuations established by our board at the end of each quarter are based on a detailed review of the relevant information on each company, considering the factors described in our annual and semiannual reports in the Notes to Portfolio of Investments.

New investments during the six months ended September 30, 2007 included \$3,000,000 invested in Atlantic Capital Bancshares, Inc., a holding company and sole shareholder of recently formed Atlantic Capital Bank headquartered in Atlanta, Georgia. Add-on investments during the period included an additional \$3,000,000 in All Components, Inc., \$1,775,857 in BankCap Partners Fund I, L.P. and \$1,050,000 in CMI Holding Company, Inc.

Capital Southwest has derived its sustained growth from the unrelenting efforts of business owners and dedicated executives who think and act like business owners. Our long-term orientation aligns us with these executives and enables us to work alongside them as they build enduring businesses. One such CEO is Mike McBath, who manages Extreme International, Inc., a producer of radio and television commercials and corporate communications videos ([www.concerts.com](http://www.concerts.com)).

In 1996, we invested \$4,551,750 in Extreme with another venture capital firm to fund the purchase of the business from its founder. In 2002, after a failed acquisition and persistent operating problems, the

company was operating at a sizable loss, which led to a major recapitalization. Our Company's investment – then \$4,551,750 – was valued at \$1,000,000. Unwilling to accept defeat, Extreme's management accepted a formidable turnaround challenge, gradually restoring the company's profitability and building sales and earnings to record levels. Their hard work and ingenuity has established Extreme as a dominant provider of commercials to the concert touring business and an innovative developer of advertising media products. These operating improvements are reflected in the \$6,566,000 growth in the value of our remaining \$3,000,000 Extreme investment to \$9,566,000 at September 30, 2007. The company's performance is a tribute to its capable management team.

On October 15, 2007, our board of directors declared a dividend of \$0.40 per share, payable on November 30, 2007 to shareholders of record on November 15th. Under the Jobs and Growth Tax Relief Reconciliation Act, dividends paid by our Company will be Qualified Dividends, taxable at a maximum rate of 15%. Our Automatic Dividend Reinvestment and Optional Cash Contribution Plan, which provides a convenient way to increase your ownership of our Company, is available to shareholders of record of 25 or more shares. To join, call us for a brochure and authorization form.

Capital Southwest will not have taxable net long-term capital gains for the tax year ended December 31, 2007. Therefore, the Company will not issue an IRS Form 2439 and shareholders will not have to report a retained capital gain or a credit for taxes paid by our Company.

In September, Tracy L. Morris joined our staff as Controller and CFO. Previously Tracy was with Best Merchant Partners, LP where she served as Controller. Tracy is a Certified Public Accountant and has a BS degree from Millersville University of Pennsylvania.

In October, the Company successfully launched its updated website. We welcome you to take a look at [www.capitalsouthwest.com](http://www.capitalsouthwest.com).

January 9, 2008

President and CEO

## Portfolio of Investments – September 30, 2007

Company	Equity (a)	Investment (b)	Cost	Value (c)
† <b>AT&amp;T INC.</b> <b>San Antonio, Texas</b> Global leader in local, long distance, Internet and transaction-based voice and data services.	<1%	‡20,770 shares common stock (acquired 3-9-99)	\$ 12	\$ 878,779
† <b>ALAMO GROUP INC.</b> <b>Seguin, Texas</b> Tractor-mounted mowing and mobile excavation equipment for governmental, industrial and agricultural markets; street-sweeping equipment for municipalities.	26.2%	2,830,300 shares common stock (acquired 4-1-73 thru 5-25-07)	2,190,937	48,115,000
<b>ALL COMPONENTS, INC.</b> <b>Austin, Texas</b> Electronics contract manufacturing; distribution and production of memory and other components for computer manufacturers, retailers and value-added resellers.	92.1%	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) Warrant to purchase 350,000 shares of common stock at \$11.00 per share, expiring 2017 (acquired 6-27-07)	6,000,000  150,000  — <hr style="width: 100%;"/> 6,150,000	6,000,000  6,600,000  — <hr style="width: 100%;"/> 12,600,000
† <b>ALLTEL CORPORATION</b> <b>Little Rock, Arkansas</b> Owner and operator of the nation's largest wireless network.	<1%	‡8,880 shares common stock (acquired 7-1-98)	88,699	618,758
† <b>ATLANTIC CAPITAL BANCSHARES, INC.</b> <b>Atlanta, Georgia</b> 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
<b>BALCO, INC.</b> <b>Wichita, Kansas</b> Specialty architectural products used in the construction and remodeling of commercial and institutional buildings.	88.5%	445,000 shares common stock and 60,920 shares Class B non-voting common stock (acquired 10-25-83 and 5-30-02)	624,920	4,500,000
<b>BOXX TECHNOLOGIES, INC.</b> <b>Austin, Texas</b> 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

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
<b>CMI HOLDING COMPANY, INC.</b> <b>Richardson, Texas</b> Owns Chase Medical, which develops and sells devices used in cardiac surgery to relieve congestive heart failure; develops and supports cardiac imaging systems.	15.4%	10% convertible subordinated note, due 2009, (acquired 7-2-07) 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 4-16-04) Warrants to purchase 431,982 shares of Series A-1 convertible preferred stock at \$1.72 per share expiring 2012 (acquired 7-2-07)	\$ 1,913,347 4,000,000 — —	\$ 1,913,347 2,000,000 — —
			<u>5,913,347</u>	<u>3,913,347</u>
† <b>COMCAST CORPORATION</b> <b>Philadelphia, Pennsylvania</b> Leading provider of cable, entertainment and communications products and services.	<1%	‡64,656 shares common stock (acquired 11-18-02)	21	1,562,089
<b>DENNIS TOOL COMPANY</b> <b>Houston, Texas</b> Polycrystalline diamond compacts (PDCs) used in oil field drill bits and in mining and industrial applications.	67.4%	20,725 shares 5% convertible preferred stock, convertible into 20,725 shares of common stock at \$48.25 per share (acquired 8-10-98) 140,137 shares common stock (acquired 3-7-94 and 8-10-98)	999,981 2,329,963 3,329,944	999,981 2,000,000 2,999,981
† <b>DISCOVERY HOLDING COMPANY</b> <b>Englewood, Colorado</b> Provider of creative content, media management and network services worldwide.	<1%	‡70,501 shares Series A common stock (acquired 7-21-05)	20,262	2,031,134
† <b>EMBARQ CORPORATION</b> <b>Overland Park, Kansas</b> Local exchange carrier that provides voice and data services, including high-speed Internet.	<1%	‡4,500 shares common stock (acquired 5-17-06)	46,532	250,200
† <b>ENCORE WIRE CORPORATION</b> <b>McKinney, Texas</b> Electric wire and cable for residential and commercial use.	16.9%	4,086,750 shares common stock (acquired 7-16-92 thru 10-7-98)	5,800,000	75,605,000

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
<b>EXTREME INTERNATIONAL, INC.</b> <b>Sugar Land, Texas</b> Owns Bill Young Productions, Texas Video and Post, and Extreme Communications, which produce radio and television commercials and corporate communications videos.	53.6%	39,359.18 shares Series C convertible preferred stock, convertible into 157,436.72 shares of common stock at \$29.00 per share (acquired 9-30-03) 3,750 shares 8% Series A convertible preferred stock, convertible into 15,000 shares of common stock at \$29.00 per share (acquired 9-30-03) Warrants to purchase 13,035 shares of common stock at \$29.00 per share, expiring 2008 (acquired 8-11-98 thru 9-30-03)	\$ 2,625,000  375,000  — <u>3,000,000</u>	\$ 8,391,000  800,000  <u>375,000</u> <u>9,566,000</u>
† <b>FMC CORPORATION</b> <b>Philadelphia, Pennsylvania</b> Chemicals for agricultural, industrial and consumer markets.	<1%	‡12,860 shares common stock (acquired 6-6-86 and 9-13-07)	66,726	668,977
† <b>FMC TECHNOLOGIES, INC.</b> <b>Houston, Texas</b> Equipment and systems for the energy, food processing and air transportation industries.	<1%	‡22,114 shares common stock (acquired 1-2-02 and 8-31-07)	57,051	1,275,093
<b>HEELYS, INC.</b> <b>Carrollton, Texas</b> Heelys stealth skate shoes, equipment and apparel sold through sporting goods chains, department stores and footwear retailers.	31.8%	9,317,310 shares common stock (acquired 5-26-00)	102,490	55,904,000
<b>HIC-STAR CORPORATION</b> <b>Dallas, Texas</b> Holding company previously engaged in mortgage banking operations, which have now been sold.	34.9%	10% subordinated note due 2007 (acquired 10-19-04 and 1-13-05) 12% subordinated notes due 2008 (acquired 3-25-05 thru 2-27-06) Warrants to purchase 463,162 shares of Series A common stock at \$1.00 per share, expiring 2014 (acquired 3-31-04 thru 1-13-05)	352,646 717,523  — <u>1,070,169</u>	— 1  <u>—</u> <u>1</u>
† <b>HOLOGIC, INC.</b> <b>Bedford, Massachusetts</b> Medical instruments including bone densitometers, mammography devices and digital radiography systems.	<1%	‡316,410 shares common stock (acquired 8-27-99)	220,000	19,282,025
† <b>KIMBERLY-CLARK CORPORATION</b> <b>Dallas, Texas</b> Manufacturer of tissue, personal care and health care products.	<1%	‡77,180 shares common stock (acquired 12-18-97)	2,358,518	5,422,667

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
† <b>LIBERTY GLOBAL, INC.</b> <b>Englewood, Colorado</b> Owns interests in broadband, distribution and content companies.	<1%	‡42,463 shares Series A common stock (acquired 6-15-05) ‡42,463 shares Series C common stock (acquired 9-6-05)	\$ 106,553 <u>100,870</u> 207,423	\$ 1,741,832 <u>1,639,496</u> 3,381,328
† <b>LIBERTY MEDIA CORPORATION</b> <b>Englewood, Colorado</b> Holding company owning interests in electronic retailing, media, communications and entertainment businesses.	<1%	‡35,250 shares of Liberty Capital Series A common stock (acquired 5-9-06) ‡176,252 shares of Liberty Interactive Series A common stock (acquired 5-9-06)	51,829 <u>66,424</u> 118,253	4,400,258 <u>3,384,038</u> 7,784,296
<b>LIFEMARK GROUP</b> <b>Hayward, California</b> Cemeteries, mausoleums and mortuaries located in northern California.	100.0%	1,449,026 shares common stock (acquired 7-16-69)	4,510,400	44,000,000
<b>MEDIA RECOVERY, INC.</b> <b>Graham, Texas</b> Computer datacenter and office automation supplies and accessories; impact, tilt monitoring and temperature sensing devices to detect mishandled shipments; dunnage for protecting shipments.	96.9%	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) 4,000,000 shares common stock (acquired 11-4-97)	800,000 <u>4,615,000</u> 5,415,000	6,000,000 <u>30,000,000</u> 36,000,000
<b>PALLETONE, INC.</b> <b>Bartow, Florida</b> Manufacturer of wood pallets and pressure-treated lumber.	8.4%	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	2,000,000 750,000 <u>61,000</u> 2,811,000
† <b>PALM HARBOR HOMES, INC.</b> <b>Dallas, Texas</b> Integrated manufacturing, retailing, financing and insuring of manufactured housing and modular homes.	30.5%	7,855,121 shares common stock (acquired 1-3-85 thru 7-31-95)	10,931,955	62,841,000
† <b>PETSMART, INC.</b> <b>Phoenix, Arizona</b> Retail chain of more than 928 stores selling pet foods, supplies and services.	<1%	‡300,000 shares common stock (acquired 6-1-95)	1,318,771	9,567,000
†Publicly-owned company		‡Unrestricted securities as defined in Note (b)		

Company	Equity (a)	Investment (b)	Cost	Value (c)
<b>THE RECTORSEAL CORPORATION</b> <b>Houston, Texas</b> 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	\$108,850,000
† <b>SPRINT NEXTEL CORPORATION</b> <b>Reston, Virginia</b> Diversified telecommunications company.	<1%	‡90,000 shares common stock (acquired 6-20-84)	457,113	1,710,000
<b>TCI HOLDINGS, INC.</b> <b>Denver, Colorado</b> Cable television systems and microwave relay systems.	–	21 shares 12% Series C cumulative compounding preferred stock (acquired 1-30-90)	–	677,250
† <b>TEXAS CAPITAL BANCSHARES, INC.</b> <b>Dallas, Texas</b> 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	10,630,432
<b>VIA HOLDINGS, INC.</b> <b>Sparks, Nevada</b> Designer, manufacturer and distributor of high-quality office seating.	28.2%	9,118 shares Series B preferred stock (acquired 9-19-05)	4,559,000	2
<b>WELLOGIX, INC.</b> <b>Houston, Texas</b> Developer and supporter of software used by the oil and gas industry to control drilling and maintenance expenses.	19.7%	4,603,093 shares Series A-1 convertible participating preferred stock, convertible into 4,603,093 shares of common stock at \$1.1011 per share (acquired 8-19-05 thru 9-15-07)	5,000,000	2
<b>THE WHITMORE MANUFACTURING COMPANY</b> <b>Rockwall, Texas</b> Specialized 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	26,600,000
† <b>WINDSTREAM CORPORATION</b> <b>Little Rock, Arkansas</b> Provider of voice, broadband and entertainment services.	<1%	‡9,181 shares common stock (acquired 7-17-06)	19,656	129,636

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
<b>MISCELLANEOUS</b>	–	BankCap Partners Fund I, L.P. – 6.0% limited partnership interest (acquired 7-14-06 thru 4-3-07)	\$ 2,371,476	\$ 2,371,476
	–	Diamond State Ventures, L.P. – 1.9% limited partnership interest (acquired 10-12-99 thru 8-26-05)	146,000	146,000
	–	First Capital Group of Texas III, L.P. – 3.3% limited partnership interest (acquired 12-26-00 thru 8-12-05)	964,604	964,604
	100.0%	Humac Company – 1,041,000 shares common stock (acquired 1-31-75 and 12-31-75)	–	178,000
	–	PharmaFab, Inc. – contingent payment agreement (acquired 2-15-07)	2	2
	–	STARTech Seed Fund I – 12.1% limited partnership interest (acquired 4-17-98 thru 1-5-00)	178,066	1
	–	STARTech Seed Fund II – 3.2% limited partnership interest (acquired 4-28-00 thru 2-23-05)	950,000	1
	–	Sterling Group Partners I, L.P. – 1.7% limited partnership interest (acquired 4-20-01 thru 1-24-05)	1,064,042	2,400,000
<b>TOTAL INVESTMENTS</b>			<b>\$80,702,891</b>	<b>\$569,235,083</b>

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

## Notes to Portfolio of Investments

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

(b) **Unrestricted securities** (indicated by ‡) are freely marketable securities having readily available market quotations. All other securities are **restricted securities** which are subject to one or more restrictions on resale and are not freely marketable. At September 30, 2007, restricted securities represented approximately 88.5% 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 listed securities and at the lower of the closing bid price or the last sale price for Nasdaq securities on the valuation date. Restricted securities, including securities of publicly-owned companies which are subject to restrictions on resale, are valued at fair value as determined by the Board of Directors. Fair value is considered to be the amount which the Company may reasonably expect to receive for portfolio securities if such securities were sold on the valuation date. Valuations as of any particular date, however, are not necessarily indicative of amounts which may ultimately be realized as a result of future sales or other dispositions of securities.

Among the factors considered by the Board of Directors in determining the fair value of restricted securities are the financial condition and operating results of the issuer, the long-term potential of the business of the is-

suor, the market for and recent sales prices of the issuer's securities, the values of similar securities issued by companies in similar businesses, the proportion of the issuer's securities owned by the Company, the nature and duration of resale restrictions and the nature of any rights enabling the Company to require the issuer to register restricted securities under applicable securities laws. In determining the fair value of restricted securities, the Board of Directors considers the inherent value of such securities without regard to the restrictive feature and adjusts for any diminution in value resulting from restrictions on resale.

(d) Agreements between certain issuers and the Company provide that the issuers will bear substantially all costs in connection with the disposition of common stocks, including those costs involved in registration under the Securities Act of 1933 but excluding underwriting discounts and commissions. These agreements cover common stocks owned at September 30, 2007 and common stocks which may be acquired thereafter through exercise of warrants and conversion of debentures and preferred stocks. They apply to restricted securities of all issuers in the investment portfolio of the Company except securities of the following issuers, which are not obligated to bear registration costs: Humac Company, Lifemark Group and The Whitmore Manufacturing Company.

(e) The descriptions of the companies and ownership percentages shown in the portfolio of investments were obtained from published reports and other sources believed to be reliable, are supplemental and are not covered by the report of independent 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.

**Capital Southwest Corporation and Subsidiaries**  
**Consolidated Statements of Financial Condition**

<b>Assets</b>	September 30 <u>2007</u> (Unaudited)	March 31 <u>2007</u> as restated	<b>Liabilities and Shareholders' Equity</b>	September 30 <u>2007</u> (Unaudited)	March 31 <u>2007</u> as restated
Investments at market or fair value			Other liabilities .....	\$ 1,341,571	\$ 1,457,847
Companies more than 25% owned			Deferred income taxes .....	<u>2,374,777</u>	<u>2,317,777</u>
(Cost: September 30, 2007 –			Total liabilities .....	<u>3,716,350</u>	<u>3,775,624</u>
\$28,758,246, March 31, 2007 –			Shareholders' equity		
\$28,632,356) .....	\$389,987,981	\$526,993,983	Common stock, \$1 par value: authorized,		
Companies 5% to 25% owned			5,000,000 shares; issued, 4,326,516		
(Cost: September 30, 2007 –			shares at September 30, 2007 and		
\$19,962,243, March 31, 2007 –			4,323,416 shares at March 31, 2007 .....	4,326,516	4,323,416
\$18,798,896) .....	82,329,351	76,398,002	Additional capital .....	116,689,936	116,373,960
Companies less than 5% owned			Undistributed net investment income .....	6,728,945	5,655,020
(Cost: September 30, 2007 –			Undistributed net realized gain on		
\$31,982,402, March 31, 2007 –			investments .....	(2,371,590)	(3,100,142)
\$24,211,045) .....	<u>96,917,751</u>	<u>77,763,048</u>	Unrealized appreciation of investments .....	488,532,193	609,512,737
Total investments			Treasury stock – at cost (437,365 shares)....	<u>(7,033,302)</u>	<u>(7,033,302)</u>
(Cost: September 30, 2007 –			Net assets at market or fair value, equivalent		
\$80,702,891, March 31, 2007 –			to \$156.04 per share at September 30, 2007		
\$71,642,297) .....	569,235,083	681,155,033	on the 3,889,151 shares outstanding and		
Cash and cash equivalents .....	31,871,482	38,844,203	\$186.75 per share at March 31, 2007 on		
Receivables .....	102,956	337,892	the 3,886,051 shares outstanding .....	<u>606,872,698</u>	<u>725,731,689</u>
Other assets .....	<u>9,379,527</u>	<u>9,170,185</u>			
			Totals .....	<u>\$610,589,048</u>	<u>\$729,507,313</u>
Totals .....	<u>\$610,589,048</u>	<u>\$729,507,313</u>			

**Capital Southwest Corporation and Subsidiaries**  
**Consolidated Statements of Operations**  
(Unaudited)

	Three Months Ended September 30		Six Months Ended September 30	
	2007	2006 as restated	2007	2006 as restated
Investment income:				
Interest.....	\$ 679,442	\$ 933,678	\$ 1,244,129	\$ 1,139,530
Dividends.....	801,467	757,935	1,164,894	1,540,501
Management and directors' fees.....	226,200	179,950	451,400	378,400
	<u>1,707,109</u>	<u>1,871,563</u>	<u>2,860,423</u>	<u>3,058,431</u>
Operating expenses:				
Salaries.....	291,085	320,334	565,221	663,799
Net pension benefit .....	(127,434)	(43,284)	(163,671)	(72,471)
Other operating expenses.....	288,194	230,737	553,158	451,965
	<u>451,845</u>	<u>507,787</u>	<u>954,708</u>	<u>1,043,293</u>
Income before interest expense and income taxes .....	1,255,264	1,363,776	1,905,715	2,015,138
Interest expense.....	-	178,222	-	325,204
Income before income taxes.....	1,255,264	1,185,554	1,905,715	1,689,934
Income tax expense.....	44,400	15,200	54,160	28,024
<b>Net investment income</b> .....	<u>\$ 1,210,864</u>	<u>\$ 1,170,354</u>	<u>\$ 1,851,555</u>	<u>\$ 1,661,910</u>
Proceeds from disposition of investments .....	\$ 402,777	\$10,045,064	\$ 728,552	\$10,442,080
Cost of investments sold.....	-	826,317	-	826,317
<b>Net realized gain on investments</b> .....	<u>402,777</u>	<u>9,218,747</u>	<u>728,552</u>	<u>9,615,763</u>
<b>Net decrease in unrealized appreciation of investments</b> .....	<u>(138,128,989)</u>	<u>(2,931,221)</u>	<u>(120,980,544)</u>	<u>(8,148,701)</u>
<b>Net realized and unrealized gain (loss) on investments</b> .....	<u>\$(137,726,212)</u>	<u>\$ 6,287,526</u>	<u>\$(120,251,992)</u>	<u>\$ 1,467,062</u>
<b>Increase (decrease) in net assets from operations</b> .....	<u>\$(136,515,348)</u>	<u>\$ 7,457,880</u>	<u>\$(118,400,437)</u>	<u>\$ 3,128,972</u>

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

	Six Months Ended <u>September 30, 2007</u> (Unaudited)	Year Ended <u>March 31, 2007</u> as restated
Operations		
Net investment income .....	\$ 1,851,555	\$ 4,233,340
Net realized gain on investments .....	728,552	14,966,296
Net increase (decrease) in unrealized appreciation of investments .....	<u>(120,980,544)</u>	<u>147,681,609</u>
Increase (decrease) in net assets from operations .....	(118,400,437)	166,881,245
Distributions from:		
Undistributed net investment income .....	(777,630)	(2,323,150)
Net realized gains deemed distributed to shareholders .....	-	(11,417,283)
Capital share transactions		
Allocated increase in share value for deemed distribution .....	-	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
Stock option expense .....	<u>87,686</u>	<u>169,003</u>
Increase (decrease) in net assets .....	(118,858,991)	167,695,699
Net assets, beginning of period as restated .....	<u>725,731,689</u>	<u>558,035,990</u>
<b>Net assets, end of period .....</b>	<b><u>\$606,872,698</u></b>	<b><u>\$725,731,689</u></b>

## Capital Southwest Corporation and Subsidiaries

### Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended September 30		Six Months Ended September 30	
	2007	2006	2007	2006
		as restated		as restated
<b>Cash flows from operating activities</b>				
Increase (decrease) in net assets from operations .....	\$(136,515,348)	\$ 7,457,880	\$(118,400,437)	\$ 3,128,972
Adjustments to reconcile increase in net assets from operations to net cash provided by operating activities:				
Proceeds from disposition of investments .....	402,777	10,045,064	728,552	10,442,080
Purchases of securities .....	(1,163,347)	(370,230)	(9,215,094)	(370,230)
Maturities of securities .....	150,000	482,491	154,500	884,936
Depreciation and amortization .....	6,272	4,022	10,681	7,887
Net pension benefit .....	(127,434)	(43,284)	(163,671)	(72,471)
Realized gain on investments after income taxes .....	(402,777)	(9,218,747)	(728,552)	(9,615,763)
Net decrease in unrealized appreciation of investments .....	138,128,989	2,931,221	120,980,544	8,148,701
Stock option expense .....	44,100	77,711	87,686	81,831
Increase (decrease) in receivables .....	50,016	(31,415)	234,936	(47,285)
(Increase) decrease in other assets .....	(23,679)	1,955	(30,408)	(17,988)
Increase (decrease) in other liabilities .....	43,779	21,727	(75,384)	(84,856)
Decrease in accrued pension cost .....	(30,266)	(36,568)	(66,834)	(71,035)
Increase in deferred income taxes .....	44,400	15,200	57,000	25,400
Net cash provided by (used in) operating activities .....	<u>607,482</u>	<u>11,337,027</u>	<u>(6,426,481)</u>	<u>12,440,179</u>
<b>Cash flows from financing activities</b>				
Decrease in note payable to bank .....	-	(150,000,000)	-	-
Distributions from undistributed net investment income .....	-	-	(777,630)	(772,050)
Proceeds from exercise of employee stock options .....	-	-	231,390	1,097,500
Net cash provided by (used in) financing activities .....	<u>-</u>	<u>(150,000,000)</u>	<u>(546,240)</u>	<u>325,450</u>
Net increase (decrease) in cash and cash equivalents .....	607,482	(138,662,973)	(6,972,721)	12,765,629
Cash and cash equivalents at beginning of period .....	<u>31,264,000</u>	<u>162,932,468</u>	<u>38,844,203</u>	<u>11,503,866</u>
Cash and cash equivalents at end of period .....	<u>\$ 31,871,482</u>	<u>\$ 24,269,495</u>	<u>\$ 31,871,482</u>	<u>\$ 24,269,495</u>
<b>Supplemental disclosure of cash flow information</b>				
Cash paid during the period for:				
Interest .....	\$ -	\$ 201,441	\$ -	\$ 325,204
Income taxes .....	\$ -	\$ -	\$ -	\$ 20,000

**Capital Southwest Corporation and Subsidiaries**  
**Selected Per Share Data**

	Three Months Ended September 30		Six Months Ended September 30		Years Ended March 31			
	(unaudited)	as restated	(unaudited)	as restated	as restated			
<b>Per Share Data</b>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Investment income .....	\$ .44	\$ .48	\$ .74	\$ .79	\$ 1.79	\$ 1.25	\$ 1.26	\$ 1.22
Operating expenses .....	(.12)	(.13)	(.25)	(.27)	(.57)	(.51)	(.51)	(.39)
Interest expense .....	—	(.04)	—	(.08)	(.12)	(.11)	(.11)	(.14)
Income taxes .....	(.01)	(.01)	(.01)	(.01)	(.01)	(.01)	(.02)	(.02)
Net investment income .....	.31	.30	.48	.43	1.09	.62	.62	.67
Distributions from undistributed net investment income .....	—	—	(.20)	(.20)	(.60)	(.60)	(.60)	(.60)
Net realized gain on investments .....	.10	2.38	.19	2.48	3.85	4.00	(2.62)	3.27
Net decrease in unrealized appreciation of investments .....	(35.52)	(.76)	(31.11)	(2.10)	38.00	32.22	7.21	29.57
Exercise of employee stock options* .....	—	—	(.09)	(.29)	(.49)	(.04)	—	(.25)
Stock option expense .....	.01	.02	.02	.02	.04	—	—	—
Adjustment to initially apply FASB No. 158, net of tax .....	—	—	—	—	.30	—	—	—
Increase (decrease) in net asset value .....	(35.10)	1.94	(30.71)	.33	42.19	36.20	5.21	32.66
Net asset value:								
Beginning of period .....	<u>191.13</u>	<u>142.95</u>	<u>186.75</u>	<u>144.56</u>	<u>144.56</u>	<u>108.36</u>	<u>103.75</u>	<u>71.09</u>
End of period .....	<u>\$156.04</u>	<u>\$144.89</u>	<u>\$156.04</u>	<u>\$144.89</u>	<u>\$186.75</u>	<u>\$144.56</u>	<u>\$108.36</u>	<u>\$103.75</u>
Shares outstanding at end of period (000s omitted) .....	3,889	3,875	3,889	3,875	3,886	3,860	3,857	3,857

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

## 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.

## Professional Staff

**Gary L. Martin**, President and Chief Executive Officer, 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. He is also a graduate of Harvard Business School's Advanced Management Program.

**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, joined Capital Southwest in 2001. Previously, he was an investment banker with Scott & Stringfellow, Inc. and a credit analyst at Bank One Corporation. He presently serves as President of the Southern Regional Association of Small Business Investment Companies and is on the Education Committee of the Venture Capital Institute and the Steering Committee of the DFW Private Equity Forum. He received an MBA with distinction from Johnson Graduate School of Management at Cornell University and a BBA from the University of Texas at Austin.

**William R. Thomas III**, Investment Associate, 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.

**Tracy L. Morris**, Controller, 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.