

## To Our Shareholders

Net asset value at December 31, 2007 was \$541,924,018, equivalent to \$139.34 per share. This net asset value does not include an accrual for deferred taxes on unrealized gains, as the Company discontinued that policy in the previous quarter. In connection with that policy change, the Company has filed an amended Annual Report Form 10-K/A for the fiscal year ended March 31, 2007 and an amended Quarterly Report Form 10-Q/A for the three months ended June 30, 2007. The net asset value at December 31, 2007 represents a decrease of 10.4% during the past three months and a decrease of 22.6% during the past twelve months.

	December 31 2007	December 31 2006 as restated
Net assets	\$541,924,018	\$703,039,495
Shares outstanding	3,889,151	3,886,051
Net asset per share	\$139.34	\$180.91

During the nine months ended December 31, 2007, unrealized appreciation of investments decreased by \$186,032,713, which included value increases of \$45,959,974 and value decreases of \$231,992,687. Approximately 60% of the increases came from two investments: 48% from The RectorSeal Corporation, which continues to grow profitably from well planned and carefully managed acquisitions and 12% from All Components, Inc., which manufactures and distributes computer memory and related components. Approximately 77% of the decreases came from two investments: 68% from Heelys, Inc., our stealth skate shoe company which experienced a market collapse and 9% from Palm Harbor Homes, Inc., which is severely challenged by the depressed manufactured housing market.

As the US economy subsides, Capital Southwest will again become a favored partner to emerging businesses that desire expansion capital. *Our Patient Capital for Exceptional Businesses* positioning statement resonates with proven managers and owners capable of building formidable companies without time constraints. We are encouraged by the increasing number of quality businesses presently seeking capital. Some of these are family-owned operations whose management wants to preserve a unique culture while ensuring long-standing growth over the next generation. Hopefully, the next several quarters will provide a more favorable investment climate. To understand our investment philosophy, please visit our recently-enhanced web site at [www.capitalsouthwest.com](http://www.capitalsouthwest.com).

During the nine months ended December 31, 2007 the Company has provided add-on capital in the aggregate amount of \$6,882,280 to five existing portfolio companies including Alamo Group Inc., All Components, Inc., BankCap Partners Fund I, L.P., CMI Holding Company, Inc. and VIA Holdings, Inc. Additionally, \$3,000,000 was invested in Atlantic Capital Bancshares, Inc., a holding company and sole shareholder of recently formed Atlantic Capital Bank headquartered in Atlanta, Georgia.



February 8, 2008 President and CEO

## Officers and Staff

GARY L. MARTIN  
President and  
Chief Executive Officer

WILLIAM M. ASHBAUGH  
Senior Vice President

JEFFREY G. PETERSON  
Vice President

WILLIAM R. THOMAS III  
Investment Associate

TRACY L. MORRIS  
Controller

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## Directors

WILLIAM R. THOMAS Dallas, Texas  
Chairman of the Board

GARY L. MARTIN  
President of the Company

DONALD W. BURTON Tampa, Florida  
General Partner, The Burton Partnership

GRAEME W. HENDERSON Pasadena, California  
Investments

SAMUEL B. LIGON Dallas, Texas  
Investments

JOHN H. WILSON Dallas, Texas  
President, U.S. Equity Corporation

## Capital Southwest Corporation

12900 Preston Road, Suite 700 • Dallas, Texas 75230  
(972) 233-8242 Fax (972) 233-7362  
[www.capitalsouthwest.com](http://www.capitalsouthwest.com)

Capital  
Southwest  
Corporation

Interim Report  
December 31, 2007

## Consolidated Statements of Financial Condition

Assets	December 31, 2007 (Unaudited)	March 31, 2007 as restated
Investments at market or fair value (Cost: December 31, 2007 – \$80,361,210 March 31, 2007 – \$71,642,297)	\$504,094,803	\$681,155,033
Cash and cash equivalents	31,949,168	38,844,203
Receivables	258,171	337,892
Other assets	9,477,698	9,170,185
Totals	<u>\$545,779,840</u>	<u>\$729,507,313</u>
<b>Liabilities and Shareholders' Equity</b>		
Other liabilities	\$ 1,452,545	\$ 1,457,847
Deferred income taxes	2,403,277	2,317,777
Total liabilities	<u>3,855,822</u>	<u>3,775,624</u>
Shareholders' equity		
Common stock, \$1 par value: authorized, 5,000,000 shares; issued, 4,326,516 shares at December 31, 2007 and 4,323,416 shares at March 31, 2007	4,326,516	4,323,416
Additional capital	116,777,926	116,373,960
Undistributed net investment income	6,979,403	5,655,020
Undistributed net realized loss on investments	(2,860,118)	(3,100,142)
Unrealized appreciation of investments	423,733,593	609,512,737
Treasury stock – at cost (437,365 shares)	(7,033,302)	(7,033,302)
Net assets at market or fair value, equivalent to \$139.34 per share at December 31, 2007 on the 3,889,151 shares outstanding and \$186.75 per share at March 31, 2007, on the 3,886,051 shares outstanding	541,924,018	725,731,689
Totals	<u>\$545,779,840</u>	<u>\$729,507,313</u>

## Consolidated Statements of Changes in Net Assets

	Nine months ended December 31, 2007 (Unaudited)	Year ended March 31, 2007 as restated
Operations:		
Net investment income	\$ 3,657,673	\$ 4,233,340
Net realized gain on investments	240,024	14,966,296
Net increase (decrease) in unrealized appreciation of investments	(185,779,143)	147,681,609
Increase (decrease) in net assets from operations	(181,881,446)	166,881,245
Distributions from:		
Undistributed net investment income	(2,333,291)	(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	175,676	169,003
Increase (decrease) in net assets	(183,807,671)	167,695,699
Net assets, beginning of period as restated	725,731,689	558,035,990
<b>Net assets, end of period</b>	<u>\$541,924,018</u>	<u>\$725,731,689</u>

## Consolidated Statements of Operations

(Unaudited)

	Three months ended December 31		Nine months ended December 30	
	2007	2006 as restated	2007	2006 as restated
Investment income:				
Interest	\$ 552,950	\$ 484,888	\$ 1,797,079	\$ 1,624,418
Dividends	1,838,757	1,626,702	3,003,651	3,167,203
Management and directors' fees	222,449	163,750	673,849	542,150
	<u>2,614,156</u>	<u>2,275,340</u>	<u>5,474,579</u>	<u>5,333,771</u>
Operating expenses:				
Salaries	380,247	310,127	945,468	973,926
Net pension benefit	(81,837)	(36,237)	(245,508)	(108,708)
Other operating expenses	481,128	238,504	1,034,286	690,469
	<u>779,538</u>	<u>512,394</u>	<u>1,734,246</u>	<u>1,555,687</u>
Income before interest expense and income taxes	1,834,618	1,762,946	3,740,333	3,778,084
Interest expense	—	133,749	—	458,953
Income before income taxes	1,834,618	1,629,197	3,740,333	3,319,131
Income tax expense	28,500	12,700	82,660	40,724
<b>Net investment income</b>	<u>\$ 1,806,118</u>	<u>\$ 1,616,497</u>	<u>\$ 3,657,673</u>	<u>\$ 3,278,407</u>
Proceeds from disposition of investments	\$ 670,339	\$ 31,578,052	\$ 1,398,891	\$ 42,020,132
Cost of investments sold	1,158,868	12,046,678	1,158,868	12,872,995
Realized gain (loss) on investments before income taxes	(488,528)	19,531,374	240,024	29,147,137
Income tax expense	—	11,080,699	—	11,080,699
<b>Net realized gain (loss) on investments</b>	(488,528)	8,450,675	240,024	18,066,438
<b>Net increase (decrease) in unrealized appreciation of investments</b>	(64,798,599)	132,210,244	(185,779,143)	124,061,543
<b>Net realized and unrealized gain (loss) on investments</b>	<u>\$ (65,287,127)</u>	<u>\$ 140,660,919</u>	<u>\$ (185,539,119)</u>	<u>\$ 142,127,981</u>
<b>Increase (decrease) in net assets from operations</b>	<u>\$ (63,481,009)</u>	<u>\$ 142,277,416</u>	<u>\$ (181,881,446)</u>	<u>\$ 145,406,388</u>