

To Our Shareholders

While my tenure at Capital Southwest Corporation began in 1972 as the Company's Chief Financial Officer, my first year as the Company's President has provided great insight as to how well our investment team grasps new opportunities, manages the existing ones, and proactively searches for value creation at every turn. Though there have been some minor process changes, the disciplined way in which we have always evaluated investment opportunities remains unchanged. We still seek to partner with exceptional businesses whose managers are ethical, driven, and capable. We still invest with our eye to the decades ahead, not the months. We still finance companies at reasonable valuations despite short-term exuberance over returns that highly-leveraged balance sheets may provide.

Perhaps a visible change since assuming my role is this annual letter itself, as my writing style is altogether different from that of Bill Thomas. While Bill's compelling letters were commentary on the Company and capitalism at large, my scope will be comparatively limited and direct. Though his comments will be missed in these pages, rest assured that the Company is maintaining its focus on capital appreciation by backing promising companies at appropriate valuations with the next half-century in mind.

Last Year's Results

Net Asset Value at March 31, 2008 was \$583,700,214, equivalent to \$150.09 per share. This net asset value does not include an accrual for deferred taxes on unrealized gains, due to the restatement that resulted in the Company filing 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. Assuming reinvestment of all dividends, the March 31, 2008 net asset value of \$150.09 was 7.7% above the December 31, 2007 net asset value of \$139.34, and 19.3% below the March 31, 2007 net asset value of \$186.75.

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 Ended March 31, 2008
Increases (decreases) in unrealized gains:	
The RectorSeal Corporation	\$ 11.88
LifeMark Group.....	7.97
The Whitmore Manufacturing Company	3.09
Heely's, Inc	(41.33)
Palm Harbor Homes, Inc.	(10.10)
Encore Wire Corporation.....	(4.73)
Other decreases	<u>(3.54)</u>
	(36.76)
Net realized gains	0.06
Net investment income	0.96
Dividends.....	(0.60)
Other changes in net assets.....	<u>(.32)</u>
Decreases in net asset value.....	(36.66)
Net asset value – beginning of period	<u>186.75</u>
Net asset value – end of period	<u>\$150.09</u>

The three investments achieving the largest increases in value during the year ended March 31, 2008 were The RectorSeal Corporation, LifeMark Group and The Whitmore Manufacturing Company. These three assets in the aggregate represent a value of \$253,200,000 or 43.4% of the total Net Asset Value of Capital Southwest Corporation. The increases in RectorSeal and Whitmore were attributable to strong earnings derived from organic growth and the performance of recent acquisitions. LifeMark Group benefited from the increase in value of its cemetery and funeral home operations, including the new LifeMark Center Funeral Home, and from continued escalations in non-business land values.

The reductions in value were predominately attributable to the publicly held positions within our portfolio including Heelys Inc., Palm Harbor Homes, Inc. and Encore Wire Corporation. 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 \$34,940,000 at March 31, 2008, a decrease of \$160,724,000. Palm Harbor Homes encountered severe financial setbacks as the real estate markets eroded during the year. Encore Wire also experienced adversity associated with the residential markets and severe competition, which negatively affected its market price.

SFAS 157 and Valuation Support

As it has done since 1961, the Company's board of directors values each of our investments at the end of every quarter. In fact, our firm was recognized by Forbes Magazine, which named Capital Southwest as one of America's Most Trustworthy companies for 2006, showing "the highest degree of accounting transparency and fair dealing to stake-holders during 2006." Thus, when the Financial Accounting Standards Board recently issued its SFAS 157 "Fair Value Measurements" in an attempt to increase companies' consistency, transparency, and disclosure in valuing assets, our quarterly valuation methods and the associated processes changed very little.

While we did not formally adopt SFAS 157 until April 1, 2008, we have applied its logic and methodology across our portfolio with our valuation at March 31, 2008. Under this accounting standard, freely marketable securities are valued at the closing market price on the valuation date, restricted marketable securities are discounted from market value based on restrictions and investment-specific factors, and privately-held portfolio companies are valued based on their specific operating factors and industry comparables. As we continue to evaluate this statement, we do not anticipate the adoption of SFAS 157 will have a material impact on our consolidated financial statements.

Our privately owned companies, especially the wholly or majority-owned companies, deserve unusually important consideration as they constitute such a large percentage of Net Assets. The value of the Company's top four wholly or majority-owned assets, including The RectorSeal Corporation, LifeMark Group, The Whitmore Manufacturing Company and Media Recovery, Inc., are now valued at \$290,700,000, representing 49.8% of Net Assets. We are pleased to continue our mission of employing the best industry practices to determine fair value across the portfolio.

Measure of Performance and Value

The growth in net asset value over the past 10 years corresponded to a compounded annual rate of 4.6%, 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, 2008 was equivalent to a compound annual rate of 17.8%. The following table reflects our Company's performance compared to the S&P 500 Index for the past 3, 5, and 10 years:

Period Ended	Investment Returns	
	*Capital <u>Southwest</u>	**S&P 500 <u>Stock Index</u>
March 31, 2008		
3 years	13.4%	5.9%
5 years	17.8	11.3
10 years	4.6	3.5

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

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

The following analysis of a share of Capital Southwest stock reflects the composition of the assets and liabilities underlying each share:

	<u>Value Per Share</u>
Major investments:	
The RectorSeal Corporation.....	\$37.08
LifeMark Group.....	18.26
Encore Wire Corporation.....	13.14
Alamo Group Inc.....	11.64
The Whitmore Manufacturing Company.....	<u>9.77</u> \$ 89.89
Other investments:	
Restricted securities.....	37.35
Marketable securities.....	<u>13.56</u> 140.80
Cash, receivables and other assets.....	<u>10.05</u>
Total assets.....	150.85
Deferred taxes.....	(0.46)
Other liabilities.....	<u>(0.30)</u>
Net assets at March 31, 2008.....	<u>\$150.09</u>

Investment Activity

For much of 2007, strong economic conditions and loose credit helped push the price of a number of promising investment opportunities into the stratosphere, well outside our willingness to invest. The run-up was influenced by a massive number of equity and mezzanine investment groups whose 10-year funds were getting on in years, driving them to invest at nearly any price in order not to lose capital investments and the associated management fees. Our philosophy and corporate structure remove the irrational urge to fund overpriced companies in frothy market environments as we continue to fund exceptional managers and companies that appreciate our *truly* long-term investment horizon. This time-tested investment strategy has generated notable returns over past years, and tends to thrive in today's market of limited credit for growth-stage companies. As lenders grow more reasonably risk adverse in today's environment, our capital is

more compelling to growth stage companies in need of a stable funding solution. Thus, our current cash levels and corresponding investment capacity are well suited for the current economic cycle. Increasingly, we are finding more fitting opportunities at appropriate valuations as companies search for stable funding sources.

The Company invested or committed an aggregate of \$10,733,536 directly into new or existing portfolio companies during the year ended March 31, 2008. These direct investments were:

- A \$3,000,000 investment in Atlantic Capital Bancshares, a highly capitalized *de novo* bank based in Atlanta, GA. With operations officially launched on May 15, 2007, the bank provides a wide array of financial products and services to underserved middle market companies through its team of experienced bankers with significant local experience.
- A \$3,000,000 follow-on investment in All Components, Inc., to facilitate the company's recapitalization by redeeming preferred stock from previous investors and repurchasing stock from three senior managers.
- A \$701,255 investment (of which \$2,000,000 was committed) in CapitalSouth Partners Fund III, which is debenture SBIC based in Charlotte, North Carolina with a disciplined investment strategy and impressive track record. The firm was founded in 1998 to provide junior capital to lower-middle market companies and today has offices in Charlotte, Raleigh, Tampa, Dallas and Louisville.
- A \$1,861,521 investment was made in BankCap Partners Fund I, LP, which was part of our \$6,000,000 commitment made in 2006. This investment was primarily used to sponsor the creation of Atlantic Capital Bancshares, in which we participated as referenced above.
- A \$1,763,347 follow-on investment in CMI Holding Company, Inc., to provide operating capital for aggressive marketing of its cardiac imaging systems.

- A \$281,523 follow-on investment in VIA Holdings, Inc. to provide working capital for company operations.
- A \$125,890 follow-on investment in Alamo Group Inc. to exercise director options for 9,000 shares, which were immediately assigned to the company.

Increase in Dividend

The Board of Directors increased the semi-annual dividend payable on May 30, 2008 to shareholders of record on May 15, 2008 to \$0.40 per share from the previous level of \$0.20 per share. This dividend increase now positions the May dividend at the same \$0.40 per share level as the most recent November dividend. The dividend increase is principally derived from increased levels of operating income generated by our wholly or majority-owned companies.

Passing of Colleagues

Capital Southwest's nearly half-century history has allowed us to work with some of the most dedicated and capable managers in the country. In February 2008, a 31-year period of friendship, cooperation, triumph and challenge ended with the passing of Lee Posey, the founder and Chairman Emeritus of Palm Harbor Homes Inc. Lee's tenacity and imposing style attracted our whole team to his teachings and practices upon which Palm Harbor was built and eventually transitioned into the hands of competent and trusted managers. We are proud to call ourselves Palm Harbor shareholders and we are blessed to have worked with Lee.

In April 2008, Robert Cooper, the former CEO and Chairman of All Components, Inc. passed away. In 1994, we backed Robert's management buyout of All Components, and he proceeded to beat his five-year forecast - a rarity in any industry, much less in the memory manufacturing and distribution business. Robert is remembered as a compassionate, hard-charging, clever risk-taker who understood how and why small businesses succeed. He will be missed.

Planning for Tomorrow

As we look to the future, the catalyst for business expansion in our wholly-owned portfolio companies will be CEOs who can drive organic growth and competently seek and incorporate add-on acquisitions. During the year ended March 31, 2008, several CEO transitions have occurred that will bolster the management teams at our portfolio company level. These promotions to the CEO level included Ray Schwertner at The Whitmore Manufacturing Company, Jerry O'Pry at RectorSeal's Cargo Blue Magic, Inc., and Tim Peddecord at All Components, Inc. Additionally, on May 20, 2008, Don Carroll was promoted to CEO of Heelys, Inc. It is upon the shoulders of portfolio company managers like these and their hard working teams that Capital Southwest will continue its growth and continued success.

June 2, 2008

President and CEO

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-owned 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 47 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, 2008

The RectorSeal Corporation	\$144,200,000
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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 9).

During the year ended March 31, 2008, RectorSeal earned \$11,264,000 on revenues of \$112,029,000, compared with earnings of \$9,676,000 on revenues of \$103,922,000 in the previous year. RectorSeal's earnings do not reflect its 20% equity in The Whitmore Manufacturing Company.

At March 31, 2008, Capital Southwest owned 100% of RectorSeal's common stock having a cost of \$52,600 and a value of \$144,200,000.

Encore Wire Corporation	\$51,084,375
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Encore Wire Corporation, McKinney, Texas, manufactures a broad line of copper electrical building wire and cable including non-metallic sheathed, underground feeder and THHN wire and cable as well as armored cable for residential, commercial and industrial construction. Encore's products are sold through distributors and building materials retailers.

For the year ended December 31, 2007, Encore reported net income of \$30,796,000 (\$1.32 per share) on net sales of \$1,184,786,000, compared with net income of \$115,133,000 (\$4.86 per share) on net sales of \$1,249,330,000 in the previous year. The March 31, 2008 closing Nasdaq bid price of Encore's common stock was \$18.18 per share.

At March 31, 2008, 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 \$51,084,375 (\$12.50 per share), representing a fully-diluted equity interest of 16.9%.

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, 2008, Lifemark reported earnings of \$529,000 on revenues of \$29,682,000, compared with earnings of \$2,239,000 on revenues of \$28,727,000 in the previous year.

At March 31, 2008, 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.

Alamo Group Inc.	\$45,284,800
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Alamo Group Inc., Seguin, Texas, is a leading designer, manufacturer and distributor of heavy-duty, tractor and truck mounted mowing and other vegetation maintenance equipment, mobile excavators, street-sweeping and snow removal equipment and replacement parts. Founded in 1969, Alamo Group operates 16 manufacturing facilities and serves governmental, industrial and agricultural markets in North America, Europe, and Australia.

For the year ended December 31, 2007, Alamo reported net income of \$12,365,000 (\$1.24 per share) on net sales of \$504,386,000, compared with net income of \$11,488,000 (\$1.16 per share) on net sales of \$456,494,000 in the previous year. The March 31, 2008 closing NYSE market price of Alamo's common stock was \$21.27 per share.

At March 31, 2008, the \$2,190,937 investment in Alamo by Capital Southwest and its subsidiary was valued at \$45,284,800 (\$16.00 per share), consisting of 2,830,300 restricted shares of common stock, representing a fully-diluted equity interest of 26.2%.

The Whitmore Manufacturing Company **\$38,000,000**

The Whitmore Manufacturing Company, Rockwall, Texas, manufactures specialty lubricants for heavy equipment used in surface mining, railroads and other industries, and produces water-based coatings for the automotive and primary metals industries. Whitmore's 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, 2008, Whitmore reported net income of \$2,879,000 on net sales of \$23,148,000, compared with net income of \$2,848,000 on net sales of \$20,863,000 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 6).

At March 31, 2008, the direct investment in 80% of Whitmore by Capital Southwest was valued at \$38,000,000 and had a cost of \$1,600,000.

Heelys, Inc. **\$34,939,913**

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, 2007, Heelys reported net income of \$22,317,000 (\$0.79 per share) on net sales of \$183,472,000, compared with net income of \$29,174,000 (\$1.16 per share) on net sales of \$188,208,000 in the previous year. The March 31, 2008 closing Nasdaq market price of Heely's common stock was \$4.29 per share.

At March 31, 2008, the \$102,490 investment in Heelys by Capital Southwest's subsidiary was valued at \$34,939,913 (\$3.75 per share), consisting of 9,317,310 restricted shares of common stock, representing a fully-diluted equity interest of 31.8%.

Media Recovery, Inc. **\$37,500,000**

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, 2007, Media Recovery reported net income of \$4,744,000 on net sales of \$134,180,000, compared with net income of \$5,164,000 on net sales of \$137,040,000 in the previous year.

At March 31, 2008, the \$5,415,000 investment in Media Recovery by Capital Southwest and its subsidiary was valued at \$37,500,000, consisting of 800,000 shares of Series A convertible preferred stock and 4,000,000 shares of common stock, representing a fully-diluted equity interest of 96.9%.

Palm Harbor Homes, Inc. **\$31,420,484**

Palm Harbor Homes, Dallas, Texas, is an integrated manufacturer and retailer of manufactured and modular housing produced in 12 plants and sold in 29 states by 87 company-owned retail stores and builder locations and approximately 275 independent dealers, builders and developers.

During the year ended March 31, 2008, Palm Harbor reported a net loss of \$124,262,000 (\$5.44 per share) on net sales of \$555,096,000, compared with net loss of \$11,565,000 (\$0.51 per share) on net sales of \$661,247,000 in the previous year. The March 31, 2008 closing Nasdaq market price of Palm Harbor's common stock was \$5.25 per share.

At March 31, 2008, the \$10,931,955 investment in Palm Harbor by Capital Southwest and its subsidiary was valued at \$31,420,484 (\$4.00 per share), consisting of 7,855,121 restricted shares of common stock, representing a fully-diluted equity interest of 30.5%.

Hologic, Inc. **\$17,586,068**

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 29, 2007, Hologic reported net income of \$94,578,000 (\$1.72 per share) on net sales of \$738,368,000, compared with net income of \$27,423,000 (\$0.56 per share) on net sales of \$462,680,000 in the previous year. The March 31, 2008 closing Nasdaq bid price of Hologic's common stock was \$55.58 per share.

At March 31, 2008, Capital Southwest and its subsidiary owned 316,410 unrestricted shares of common stock, having a cost of \$220,000 and a market value of \$17,586,068 (\$55.58 per share).

Texas Capital Bancshares, Inc. **\$8,265,393**

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, 2007, Texas Capital reported net income of \$29,422,000 (\$1.10 per share), compared with net income of \$28,924,000 (\$1.09 per share) in the previous year. The March 30, 2008 closing Nasdaq price of Texas Capital's common stock was \$16.88 per share.

At March 31, 2008, Capital Southwest owned 489,656 unrestricted shares of common stock, having a cost of \$3,550,006 and a market value of \$8,265,393 (\$16.88 per share).

All Components, Inc. **\$12,600,000**

All Components, Inc., Austin, Texas, distributes and produces memory and other electronic components for personal computer manufacturers, retailers, value-added resellers and other corporate customers. Through its Austin-based sales and distribution center and its contract manufacturing plants in Austin, Texas and Boise, Idaho, the company serves over 2,000 customers throughout the United States.

During the year ended August 31, 2007, All Components reported net income of \$134,000 on net sales of \$239,565,000, compared with net income of \$968,000 on net sales of \$275,449,000 in the previous year.

At March 31, 2008, the \$6,150,000 investment in All Components by Capital Southwest and its subsidiary was valued at \$12,600,000 consisting of an 8.25% subordinated note valued at its cost of \$6,000,000 and 150,000 shares of Series A Convertible Preferred Stock valued at \$6,600,000, representing a 79.9% fully-diluted equity interest.

Extreme International, Inc. **\$7,985,000**

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, 2007, Extreme reported net income of \$1,688,000 on net sales of \$12,470,000, compared with net income of \$1,203,000 on net sales of \$10,342,000 in the previous year.

At March 31, 2008, 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 warrants to purchase 13,035 shares of common stock at \$25 per share, having a cost of \$3,000,000 and a market value of \$7,985,000, representing a fully-diluted equity interest of 53.6%.

Portfolio of Investments – March 31, 2008

Company	Equity (a)	Investment (b)	Cost	Value (c)
† AT&T, INC. San Antonio, Texas 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	\$ 795,491
† ALAMO GROUP INC. Seguin, Texas Tractor-mounted mowing and mobile excavation equipment for governmental, industrial and agricultural markets; street-sweeping equipment for municipalities.	26.2%	2,830,300 shares common stock (acquired 4-1-73 thru 5-25-07)	2,190,937	45,284,800
ALL COMPONENTS, INC. Austin, Texas Electronics contract manufacturing; distribution and production of memory and other components for computer manufacturers, retailers and value-added resellers.	79.9%	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 — <u>6,150,000</u>	6,000,000 6,600,000 — <u>12,600,000</u>
† 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.	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
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 — — <u>6,363,347</u>	1,000,000 2 — — <u>1,000,002</u>

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
† COMCAST CORPORATION Philadelphia, Pennsylvania Leading provider of cable, entertainment and communications products and services.	<1%	‡64,656 shares common stock (acquired 11-18-02)	\$ 21	\$ 1,248,508
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>2,000,000</u> 2,999,981
† DISCOVERY HOLDING COMPANY Englewood, Colorado Provider of creative content, media management and network services worldwide.	<1%	‡70,501 shares Series A common stock (acquired 7-21-05)	20,262	1,492,506
† EMBARQ CORPORATION Overland Park, Kansas 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	180,450
† ENCORE WIRE CORPORATION McKinney, Texas 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	51,084,375
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%	39,359.18 shares Series C Convertible Preferred Stock, convertible into 157,436.72 shares of common stock at \$25.00 per share (acquired 9-30-03) 3,750 shares 8% Series A Convertible Preferred Stock, convertible into 15,000 shares of common stock at \$25.00 per share (acquired 9-30-03) Warrants to purchase 13,035 shares of common stock at \$25.00 per share, expiring 2008 (acquired 8-11-98 thru 9-30-03)	2,625,000 375,000 — <u>3,000,000</u>	7,026,000 669,000 <u>290,000</u> <u>7,985,000</u>
† FMC CORPORATION Philadelphia, Pennsylvania Chemicals for agricultural, industrial and consumer markets.	<1%	‡12,860 shares common stock (acquired 6-6-86 and 9-13-07)	66,726	713,601
† FMC TECHNOLOGIES, INC. Houston, Texas 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	1,258,065

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
†HEELYS, INC. Carrollton, Texas 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	\$34,939,913
†HOLOGIC, INC. Bedford, Massachusetts Medical instruments including bone densitometers, mammography devices and digital radiography systems.	<1%	‡316,410 shares common stock (acquired 8-27-99)	220,000	17,586,068
†KIMBERLY-CLARK CORPORATION Dallas, Texas Manufacturer of tissue, personal care and health care products.	<1%	‡77,180 shares common stock (acquired 12-18-97)	2,358,518	4,981,969
†LIBERTY GLOBAL, INC. Englewood, Colorado Owns interests in broadband, distribution and content companies.	<1%	‡42,463 shares Series A common stock (acquired 6-15-05) ‡42,463 shares Series C common stock (acquired 9-6-05)	106,553 <u>100,870</u> 207,423	1,446,714 <u>1,377,500</u> 2,824,214
†LIBERTY MEDIA CORPORATION Englewood, Colorado Holding company owning interests in electronic retailing, media, communications and entertainment businesses.	<1%	‡35,250 shares Liberty Capital Series A common stock (acquired 5-9-06) ‡176,252 shares Liberty Interactive Series A common stock (acquired 5-9-06) ‡141,000 shares Liberty Entertainment Series A common stock (acquired 3-3-08)	7,833 66,424 <u>43,996</u> 118,253	554,130 2,842,945 <u>3,148,530</u> 6,545,605
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
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.	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	6,250,000 <u>31,250,000</u> 37,500,000
PALLETONE, INC. Bartow, Florida Manufacturer of wooden 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

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
† PALM HARBOR HOMES, INC. Dallas, Texas Integrated manufacturing, retailing, financing and insuring of manufactured housing and modular homes.	30.5%	7,855,121 shares common stock (acquired 1-3-85 thru 7-31-95)	\$10,931,955	\$31,420,484
† PETSMART, INC. Phoenix, Arizona 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	6,123,000
THE RECTORSEAL CORPORATION Houston, Texas Specialty chemicals for plumbing, HVAC, electrical, construction, industrial, oil field and automotive applications; smoke containment systems for building fires; 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	144,200,000
† SPRINT NEXTEL CORPORATION Reston, Virginia Diversified telecommunications company.	<1%	‡90,000 shares common stock (acquired 6-20-84)	457,113	602,100
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	8,265,393
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>281,523</u> 281,525
WELLOGIX, INC. Houston, Texas Developer and supporter of software used by the oil and gas industry to control drilling and maintenance expenses.	19.7%	4,726,161 shares Series A-1 Convertible Participating Preferred Stock, convertible into 4,726,161 shares of common stock at \$1.0579 per share (acquired 8-19-05 thru 3-15-08)	5,000,000	2
THE WHITMORE MANUFACTURING COMPANY Rockwall, Texas 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	38,000,000
† WINDSTREAM CORPORATION Little Rock, Arkansas Provider of voice, broadband and entertainment services.	<1%	‡9,181 shares common stock (acquired 7-17-06)	19,656	109,713

†Publicly-owned company

‡Unrestricted securities as defined in Note (b)

Company	Equity (a)	Investment (b)	Cost	Value (c)
MISCELLANEOUS	–	BankCap Partners Fund I, L.P. – 6.0% limited partnership interest (acquired 7-14-06 thru 12-21-07)	\$ 2,457,140	\$ 2,457,140
	–	CapitalSouth Partners Fund III, L.P. – 2.8% limited partnership interest (acquired 1-22-08)	701,256	701,256
	–	Diamond State Ventures, L.P. – 1.9% limited partnership interest (acquired 10-12-99 thru 8-26-05)	111,000	111,000
	–	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)	–	181,000
	–	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	1,144,481
TOTAL INVESTMENTS			<u>\$81,027,466</u>	<u>\$547,570,502</u>

†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 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, 2008, restricted securities represented approximately 90.4% 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. The values of the Company's top four wholly or majority owned assets determined by our Board of Directors, were reviewed by a nationally-recognized valuation firm as of March 31, 2008.

(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, 2008 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>
Alamo Group Inc.	\$ 125,890
All Components, Inc.	3,000,000
Atlantic Capital Bancshares, Inc.	3,000,000
BankCap Partners Fund I, L.P.	1,861,521
CapitalSouth Partners Fund III, L.P.	701,255
CMI Holding Company, Inc.	1,763,347
VIA Holdings, Inc.	281,523
	<u>\$10,733,536</u>

Dispositions

	<u>Cost</u>	<u>Amount Received</u>
Alltel Corporation	\$ 88,699	\$ 634,920
Diamond State Ventures, L.P.	35,000	35,000
Exopack, Inc.	-	245,950
Hic-Star Corporation	1,070,168	1
Sterling Group Partners I, L.P.	-	518,020
	<u>\$1,193,867</u>	<u>\$1,433,891</u>
Repayments Received		<u>\$154,500</u>

Capital Southwest Corporation and Subsidiaries
Consolidated Statements of Financial Condition

Assets	March 31		Liabilities and Shareholders' Equity	March 31	
	2008	2007		2008	2007
Investments at market or fair value			Other liabilities	\$ 1,187,796	\$ 1,457,847
Companies more than 25% owned			Deferred income taxes.....	<u>1,797,058</u>	<u>2,317,777</u>
(Cost: 2008 – \$28,758,246,			Total liabilities	<u>2,984,854</u>	<u>3,775,624</u>
2007 - \$28,632,356).....	\$410,026,178	\$526,993,983	Shareholders' equity		
Companies 5% to 25% owned			Common stock, \$1 par value: authorized,		
(Cost: 2008 – \$20,412,243,			5,000,000 shares; issued, 4,326,516		
2007 - \$18,798,896).....	54,895,381	76,398,002	shares at March 31, 2008 and 4,323,416		
Companies less than 5% owned			shares at March 31, 2007.....	4,326,516	4,323,416
(Cost: 2008 – \$31,856,977,			Additional capital	115,687,153	116,373,960
2007 - \$24,211,045).....	<u>82,648,943</u>	<u>77,763,048</u>	Undistributed net investment income.....	7,036,929	5,655,020
Total investments			Undistributed net realized loss on		
(Cost: 2008 – \$81,027,466,			investments	(2,860,118)	(3,100,142)
2007 – \$71,642,297).....	547,570,502	681,155,033	Unrealized appreciation of investments	466,543,036	609,512,737
Cash and cash equivalents	31,327,758	38,844,203	Treasury stock – at cost		
Receivables	156,322	337,892	(437,365 shares)	<u>(7,033,302)</u>	<u>(7,033,302)</u>
Other assets	<u>7,630,486</u>	<u>9,170,185</u>	Net assets at market or fair value, equivalent		
			to \$150.09 per share at March 31, 2008 on		
			the 3,889,151 shares outstanding and		
			\$186.75 per share at March 31, 2007 on the		
			3,886,051 shares outstanding	<u>583,700,214</u>	<u>725,731,689</u>
Totals	<u>\$586,685,068</u>	<u>\$729,507,313</u>	Totals.....	<u>\$586,685,068</u>	<u>\$729,507,313</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		
	2008	2007	2006
Investment income:			
Interest.....	\$ 2,255,550	\$ 2,308,660	\$ 505,536
Dividends.....	3,656,833	3,954,875	3,485,430
Management and directors' fees.....	882,300	708,900	848,070
	<u>6,794,683</u>	<u>6,972,435</u>	<u>4,839,036</u>
Operating expenses:			
Salaries.....	1,619,008	1,356,062	1,211,584
Net pension benefit.....	(327,345)	(144,945)	(116,747)
Other operating expenses.....	1,676,660	1,014,255	859,702
	<u>2,968,323</u>	<u>2,225,372</u>	<u>1,954,539</u>
Income before interest expense and income taxes.....	3,826,360	4,747,063	2,884,497
Interest expense.....	-	460,399	436,021
Income before income taxes.....	3,826,360	4,286,664	2,448,476
Income tax expense.....	111,160	53,324	59,220
Net investment income	<u>\$ 3,715,200</u>	<u>\$ 4,233,340</u>	<u>\$ 2,389,256</u>
Proceeds from disposition of investments.....	\$ 1,433,891	\$ 42,919,988	\$ 30,802,552
Cost of investments sold.....	1,193,867	16,872,993	10,523,986
Realized gain on investments before income taxes.....	240,024	26,046,995	20,278,566
Income tax expense.....	-	11,080,699	4,827,663
Net realized gain on investments	<u>240,024</u>	<u>14,966,296</u>	<u>15,450,903</u>
Net increase (decrease) in unrealized appreciation of investments.....	(142,969,698)	147,681,609	124,355,303
Net realized and unrealized gain (loss) on investments	<u>\$(142,729,674)</u>	<u>\$162,647,905</u>	<u>\$139,806,206</u>
Increase (decrease) in net assets from operations	<u>\$(139,014,474)</u>	<u>\$166,881,245</u>	<u>\$142,195,462</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		
	2008	2007	2006
Operations:			
Net investment income	\$ 3,715,200	\$ 4,233,340	\$ 2,389,256
Net realized gain on investments	240,024	14,966,296	15,450,903
Net increase (decrease) in unrealized appreciation of investments	<u>(142,969,698)</u>	<u>147,681,609</u>	<u>124,355,303</u>
Increase (decrease) in net assets from operations	(139,014,474)	166,881,245	142,195,462
Distributions from:			
Undistributed net investment income	(2,333,291)	(2,323,150)	(2,314,231)
Net realized gains deemed distributed to shareholders	-	(11,417,283)	(13,573,139)
Capital share transactions:			
Allocated increase in share value for deemed distribution	-	11,417,283	13,573,139
Exercise of employee stock options	231,390	1,794,850	208,000
Adjustment to initially apply FASB No. 158, net of tax	-	1,173,751	-
Change in pension plan funded status	(1,178,764)	-	-
Stock option expense	<u>263,664</u>	<u>169,003</u>	<u>-</u>
Increase (decrease) in net assets	(142,031,475)	167,695,699	140,089,231
Net assets, beginning of year	<u>725,731,689</u>	<u>558,035,990</u>	<u>417,946,759</u>
Net assets, end of year	<u>\$583,700,214</u>	<u>\$725,731,689</u>	<u>\$558,035,990</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		
	2008	2007	2006
Cash flows from operating activities			
Increase (decrease) in net assets from operations.....	\$(139,014,474)	\$ 166,881,245	\$ 142,195,462
Adjustments to reconcile increase in net assets from operations to net cash provided by (used in) operating activities:			
Proceeds from disposition of investments.....	1,433,891	42,919,988	30,802,552
Purchases of securities	(10,733,536)	(803,269)	(15,054,741)
Maturities of securities.....	154,500	884,935	480,197
Depreciation and amortization.....	32,756	16,808	16,136
Net pension benefit.....	(327,345)	(144,945)	(116,747)
Realized gain on investments before income taxes.....	(240,024)	(14,966,296)	(15,450,905)
Net (increase) decrease in unrealized appreciation of investments	142,969,698	(147,681,609)	(124,355,303)
Stock option expense	263,664	169,003	-
(Increase) decrease in receivables	181,570	(202,005)	514
Increase in other assets	(80,195)	(39,982)	(3,226)
Increase (decrease) in other liabilities.....	(33,281)	8,934	(67,245)
Decrease in accrued pension liability	(135,768)	(144,171)	(154,673)
Increase in deferred income taxes	114,000	50,700	40,800
Net cash provided by (used in) operating activities	(5,414,544)	46,949,336	18,332,821
Cash flows from financing activities			
Decrease in note payable to bank	-	(8,000,000)	-
Decrease in note payable to portfolio company.....	-	-	(5,000,000)
Distributions from undistributed net investment income	(2,333,291)	(2,323,150)	(2,314,231)
Proceeds from exercise of employee stock options	231,390	1,794,850	208,000
Payment of federal income tax for deemed capital gains distribution	-	(11,080,699)	(4,827,659)
Net cash used in financing activities	(2,101,901)	(19,608,999)	(11,933,890)
Net increase (decrease) in cash and cash equivalents	(7,516,445)	27,340,337	6,398,931
Cash and cash equivalents at beginning of year	38,844,203	11,503,866	5,104,935
Cash and cash equivalents at end of year.....	\$ 31,327,758	\$ 38,844,203	\$ 11,503,866
Supplemental disclosure of cash flow information:			
Cash paid during the year for: Interest.....	\$ -	\$ 460,399	\$ 436,920
Income taxes	\$ -	\$ 20,000	\$ 18,420

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.

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 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 mea-

surement 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 wholly-owned portfolio companies. 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, 2008 and March 31, 2007, the Company recognized compensation expense of \$263,664 and \$169,003, respectively.

As of March 31, 2008, the total remaining unrecognized compensation cost related to non-vested stock options was \$1,795,834 which will be amortized over the weighted-average service period of approximately 5.90 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.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*, ("SFAS 157"). Effective April 1, 2008, the Company adopted SFAS 157. In February 2008, the FASB issued Staff Position No. 157-2, Effective Date of FASB Statement No. 157 ("FSP 157-2"), which delayed the effective date of SFAS 157 for certain nonfinancial

assets and liabilities, including fair value measurements under SFAS 141 and SFAS 142 of goodwill and other intangible assets, to fiscal years beginning after November 15, 2008. Therefore, the Company has adopted the provisions of SFAS 157 with respect to its financial assets and liabilities only. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. Fair value is defined under SFAS 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on the following three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value: Level 1 – Quoted prices in active markets for identical assets or liabilities; Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. The Company is currently evaluating this statement and does not anticipate that the adoption of SFAS 157 will have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities"* ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The Company is currently evaluating this statement and has made elections. However, our invest-

ments are carried at fair value, the Company does not anticipate that this Statement would have a significant impact on the consolidated financial statements.

2. Valuation of Investments

The consolidated financial statements as of March 31, 2008 and 2007 include restricted securities valued at \$494,843,820 (90.4% of the value of the consolidated investment portfolio) and \$619,207,702 (90.9% of the value of the consolidated investment portfolio), respectively, whose values have been determined by the Board of Directors in the absence of readily ascertainable market values. Because of the inherent uncertainty of valuation, these values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material. 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.

3. Income Taxes

For the tax years ended December 31, 2007 and 2006, CSC and CSVC qualified to be taxed as RICs under applicable provisions of the Internal Revenue Code. As RICs, CSC and CSVC must distribute at least 90% of their taxable net investment income (investment company taxable income) and may either distribute or retain their taxable net realized gain on investments (capital gains). To the extent that we retain capital gains and declare a deemed dividend to shareholders, at the corporate rate, on the distribution, and the shareholders would receive a tax credit equal to their proportionate share of the tax paid.

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.

As permitted by the Internal Revenue Code, 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, 2007 and 2006 we declared and paid dividends in the amounts of \$2,333,291 and \$2,323,150, 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 during our tax year. For the tax years ended December 31, 2007 and 2006, 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 years ended December 31, 2007 and 2006.

For the tax year ended December 31, 2007, we have an estimated net long-term capital loss of \$961,655 for tax purposes and \$860,118 for book purposes, which will be carried forward and offset by future net long-term capital gains. For the tax year ended December 31, 2006, we had net long-term capital gains of \$31,659,140 for tax purposes and \$31,932,775 for book purposes, which we elected to retain and treat as a deemed distribution to our shareholders. In order to make the election to retain capital gains, we incurred and paid a federal tax on behalf of our shareholders of \$11,080,699 for the tax year ended December 31, 2006.

CSMC, a wholly owned subsidiary of CSC, is not a RIC and is required to pay taxes at the current corporate rate. The Company sponsors a qualified defined benefit pension plan which covers its employees and employees of certain of our 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 income tax purposes, the \$11,417,283 and \$13,573,139 are treated as deemed distributions to our shareholders for the tax years ended December 31, 2006 and 2005. We reclassified the deemed distribution, net of tax, from our undistributed net realized earnings capital in excess of par value. For the tax year ended December 31, 2004, to the extent we had capital gains, they were fully offset by either capital losses or capital loss carry forwards.

As of March 31, 2008 and 2007, 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:

<u>As of March 31,</u>	<u>2008</u>	<u>2007</u>
Undistributed net realized gains (losses) on investments	(\$2,860,118)	(\$3,100,142)

5. Employee Stock Option Plan

On July 19, 1999, shareholders approved the 1999 Stock Option

Plan (“Plan”), which provided for the granting of stock options to employees and officers of the Company and authorized 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, 2008, there were 37,500 shares available for grant under the Plan. The per share weighted-average fair value of the stock options granted on May 15, 2006 was \$31.276 per option using the Black-Scholes pricing model with the following assumptions: expected dividend yield of 0.64%, risk-free interest rate of 5.08%, expected volatility of 21.1%, and expected life of 7 years. The per share weighted-average fair value of the stock options granted on July 17, 2006 was \$33.045 per option using the Black-Scholes pricing model with the following assumptions: expected dividend yield of 0.61%, risk-free interest rate of 5.04%, expected volatility of 21.2%, and expected life of 7 years. The per share weighted-average fair value of the stock options granted on July 16, 2007 was \$41.78 per option using the Black-Scholes pricing model with the following assumptions: expected dividend yield of 0.39%, risk-free interest rate of 4.95%, expected volatility of 19.9%, and expected life of 5 years.

The following summarizes activity in the stock option plans for the years ended March 31, 2008, 2007 and 2006:

	Number of shares	Weighted Average Exercise Price
Balance at March 31, 2006	45,300	\$ 68.411
Granted	57,500	94.136
Exercised	(25,800)	69.568
Canceled	<u>(24,500)</u>	<u>89.482</u>
Balance at March 31, 2007	52,500	86.184
Granted	25,000	152.980
Exercised	(3,100)	74.642
Canceled	<u>(4,000)</u>	<u>93.490</u>
Balance at March 31, 2008	<u>70,400</u>	<u>\$109.998</u>

	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
March 31, 2008		
Outstanding	5.9 years	\$2,184,883
Exercisable	5.5 years	\$ 241,320

At March 31, 2008, the range of exercise prices and weighted-average remaining contractual life of outstanding options was \$65.00 to \$152.98 and 5.91 years, respectively. The total intrinsic value of options exercised during the years ended March 31, 2008, 2007 and 2006 were \$75,129, \$571,565 and \$66,147, respectively. The exercise prices ranged from \$65.00 to \$93.49 per share for the year ended March 31, 2008 and \$65.00 to \$77.00 per share for the each of the years ended March 31, 2007 and 2006. New shares were issued for the \$231,390, \$1,794,850 and \$208,000 cash received from option exercises for the years ended March 31, 2008, 2007 and 2006, respectively.

At March 31, 2008, 2007 and 2006, the number of options exercisable was 9,930, 8,515 and 29,500, respectively and the weighted-average exercise price of those options was \$79.01, \$78.51 and \$69.01, respectively.

6. Employee Stock Ownership Plan

The Company and one of its wholly-owned portfolio companies sponsor a qualified employee stock ownership plan (“ESOP”) in which certain employees participate. Contributions to the plan, which are invested in Company stock, are made at the discretion of the Board of Directors. A participant’s interest in contributions to the ESOP fully vests after five years of active service.

Effective April 1, 2007, the vesting period for the ESOP is three years. During the 3 years ended March 31, 2008, the Company made contributions to the ESOP, which were charged against net investment income, of \$94,210 in 2008, \$84,488 in 2007 and \$99,167 in 2006.

7. Retirement Plans

The Company sponsors a qualified defined benefit pension plan which covers its employees and employees of certain of its wholly-owned portfolio companies. The following information about the plan represents amounts and information related to the Company's participation in the plan and is presented as though the Company sponsored a single-employer plan. Benefits are based on years of service and an average of the highest five consecutive years of compensation during the last 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, 2008.

The following tables set forth the qualified plan's benefit obligations and fair value of plan assets at March 31, 2008, 2007 and 2006:

	Years Ended March 31		
	2008	2007	2006
Change in benefit obligation			
Benefit obligation at beginning of year	\$3,965,100	\$4,004,017	\$3,833,411
Service cost	67,514	103,342	95,590
Interest cost	222,895	230,711	223,374
Actuarial loss.....	(160,840)	68,854	228,122
Benefits paid	(395,384)	(386,982)	(376,480)
Plan change	-	(54,842)	-
Benefit obligation at end of year	<u>\$3,699,285</u>	<u>\$3,965,100</u>	<u>\$4,004,017</u>

Change in plan assets

Fair value of plan assets at beginning of year	\$12,973,292	\$11,640,693	\$ 9,326,254
Actual return on plan assets.....	(1,457,571)	1,719,581	2,690,919
Benefits paid	<u>(395,384)</u>	<u>(386,982)</u>	<u>(376,480)</u>
Fair value of plan assets at end of year	<u>\$11,120,337</u>	<u>\$12,973,292</u>	<u>\$11,640,693</u>

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

	March 31	
	2008	2007
Actuarial present value of benefit obligations:		
Accumulated benefit obligation	<u>\$(3,387,397)</u>	<u>\$(3,435,396)</u>
Projected benefit obligation for service rendered to date	\$ (3,699,285)	\$ (3,965,100)
Plan assets at fair value*	<u>11,120,337</u>	<u>12,973,292</u>
Funded status	7,421,052	9,008,192
Unrecognized net (gain) loss from past experience different from that assumed and effects of changes in assumptions	209,044	(1,761,054)
Unrecognized prior service costs	129,179	132,904
Additional asset, FAS 158	<u>(338,223)</u>	<u>1,628,150</u>
Prepaid pension cost included in other assets.....	<u>\$ 7,421,052</u>	<u>\$ 9,008,192</u>

*Primarily equities and bonds including approximately 25,000 shares of common stock of the Company.

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

	Years Ended March 31		
	2008	2007	2006
Service cost – benefits earned during the year	\$ 67,514	\$ 103,342	\$ 95,590
Interest cost on projected benefit obligation	222,895	230,711	223,374
Expected return on assets	(673,366)	(580,104)	(551,026)
Net amortization	<u>3,725</u>	<u>27,487</u>	<u>38,897</u>
Net pension benefit from qualified plan	<u>\$(379,232)</u>	<u>\$(218,564)</u>	<u>\$(193,165)</u>

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

The following table sets forth the Retirement Restoration Plan's benefit obligations at March 31, 2008, 2007 and 2006:

	Years Ended March 31		
	2008	2007	2006
Change in benefit obligation			
Benefit obligation at beginning of year.....	\$1,178,891	\$1,280,542	\$1,302,368
Service cost.....	10,483	20,245	19,094
Interest cost.....	57,588	68,937	72,886
Actuarial (gain) loss	(169,072)	(36,529)	40,867
Benefits paid	(135,768)	(144,170)	(154,673)
Plan change.....	-	(10,134)	-
Benefit obligation at end of year	<u>\$ 942,122</u>	<u>\$1,178,891</u>	<u>\$1,280,542</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	
	2008	2007
Projected benefit obligation	\$(942,122)	\$(1,178,891)
Unrecognized net loss from past experience different from that assumed and effects of changes in assumptions	(112,552)	56,523
Unrecognized prior service costs	(217,958)	(234,144)
Additional asset, FAS 158.....	<u>330,510</u>	<u>177,621</u>
Accrued pension cost included in other liabilities	<u>\$(942,122)</u>	<u>\$(1,178,891)</u>

The Retirement Restoration Plan expenses recognized during the years ended March 31, 2008, 2007 and 2006 of \$51,885, \$73,619 and \$76,417, respectively, are offset against the net pension benefit from the qualified plan.

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

	Years Ended March 31		
	2008	2007	2006
Discount rate.....	6.25%	6.0%	5.75%
Rate of compensation increases.....	5.0%	5.0%	5.0%

The following assumptions were used in estimating the net periodic (income)/expense:

	Years Ended March 31		
	2008	2007	2006
Discount rate.....	6.0%	5.75%	5.75%
Expected return on plan assets.....	6.5%	6.0%	6.0%
Rate of compensation increases.....	5.0%	5.0%	5.0%

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

The Company's pension plan asset allocations are as follows:

Asset Category	Percentage of plan assets at March 31	
	2008	2007
Equity securities.....	75.0%	79.1%
Debt securities.....	13.8%	11.4%
Cash	<u>11.2%</u>	<u>9.5%</u>
	<u>100.0%</u>	<u>100.0%</u>

The Company's pension plan is administered by a board-appointed committee of that has fiduciary responsibility for the plan's manage-

ment. 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 the Company's stock.

Following are the expected benefit payments for the next five years and in the aggregate for the years 2014-2018:

(In Thousands)	Years Ended March 31					2014-
	2009	2010	2011	2012	2013	2018
	\$362	\$339	\$316	\$301	\$277	\$1,143

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

8. Commitments

The Company has agreed, subject to certain conditions, to invest up to \$5,429,760 in 3 portfolio companies.

The Company leases office space under an operating lease which requires base annual rentals of approximately \$80,000 through February, 2013. For the three years ended March 31, total rental expense charged to investment income was \$80,569 in 2008, \$79,979 in 2007 and \$76,877 in 2006.

9. Sources of Income

Income was derived from the following sources:

Years Ended March 31 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	1,421,722	-	-	-
	<u>\$2,255,550</u>	<u>\$3,656,833</u>	<u>\$882,300</u>	<u>\$240,024</u>

Years Ended March 31 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	1,244,166	-	-	-
	<u>\$2,308,660</u>	<u>\$3,954,875</u>	<u>\$708,900</u>	<u>\$26,046,995</u>

Years Ended March 31 2006	Investment Income			Realized Gain (Loss) on Investments Before Income Taxes
	Interest	Dividends	Other Income	
Companies more than 25% owned	\$ -	\$2,926,964	\$642,500	\$ -
Companies 5% to 25% owned	(55,236)	188,233	10,000	-
Companies less than 5% owned	302,622	370,233	195,570	20,278,566
Other sources, including temporary investments	258,150	-	-	-
	<u>\$505,536</u>	<u>\$3,485,430</u>	<u>\$848,070</u>	<u>\$20,278,566</u>

Selected Per Share Data and Ratios

	Years Ended March				
	2008	2007	2006	2005	2004
Per Share Data					
Investment income	\$ 1.75	\$ 1.79	\$ 1.25	\$ 1.26	\$ 1.22
Operating expenses	(.76)	(.57)	(.51)	(.51)	(.39)
Interest expense	-	(.12)	(.11)	(.11)	(.14)
Income taxes	(.03)	(.01)	(.01)	(.02)	(.02)
Net investment income .....	.96	1.09	.62	.62	.67
Distributions from undistributed net investment income	(.60)	(.60)	(.60)	(.60)	(.60)
Net realized gain (loss) on investments .....	.06	3.85	4.00	(2.62)	3.27
Net increase (decrease) in unrealized appreciation of investments	(36.76)	38.00	32.22	7.21	29.57
Exercise of employee stock options*	(.09)	(.49)	(.04)	-	(.25)
Stock option expense .....	.07	.04	-	-	-
Net change in pension plan funded status	(.30)	-	-	-	-
Adjustment to initially apply FASB No. 158, net of tax	-	.30	-	-	-
Increase (decrease) in net asset value	(36.66)	42.19	36.20	4.61	32.66
Net asset value					
Beginning of year	186.75	144.56	108.36	103.75	71.09
End of year	<u>\$150.09</u>	<u>\$186.75</u>	<u>\$144.56</u>	<u>\$108.36</u>	<u>\$103.75</u>
Ratios and Supplemental Data					
Ratio of operating expenses to average net assets .....	.46%	.36%	.42%	.49%	.47%
Ratio of net investment income to average net assets .....	.58%	.68%	.51%	.60%	.81%
Portfolio turnover rate .....	.22%	.13%	2.36%	.56%	3.74%
Net asset value total return	19.27%	29.85%	34.31%	5.25%	47.42%
Shares outstanding at end of period (000s omitted)	3,889	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.

Management's Report on Internal Control Over Financial Reporting

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

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

The Company has assessed the effectiveness of its internal control over financial reporting as of March 31, 2008. 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, 2008, the Company's internal control over financial reporting was effective.

During the fiscal quarter ended March 31, 2008, the Company 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 the Company will consult with a RIC compliance expert, on our current RIC status and the potential impact of proposed transactions and scenarios on the Company's future RIC compliance status. The Company 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, 2008, has issued an attestation report on our internal control over financial reporting as of March 31, 2008. That report appears on the next page.

Date: May 23, 2008

/s/ Gary L. Martin

Gary L. Martin
President & Chief Executive Officer

/s/ Tracy L. Morris

Tracy L. Morris
Controller
(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, 2008, 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, 2008, 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, 2008 and 2007, including the portfolio of investments as of March 31, 2008, and the related consolidated statements of operations, changes in net assets, cash flows, and the selected per share data and ratios for each of the three years in the period ended March 31, 2008, and our report dated May 23, 2008 expressed an unqualified opinion.

/s/Grant Thornton LLP

Dallas, Texas
May 23, 2008

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, 2008 and 2007, including the portfolio of investments as of March 31, 2008, 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, 2008, and the selected per share data and ratios for each of the four years in the period ended March 31, 2008. 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. The selected per share data and ratios for the year ended March 31, 2004, were audited by another independent registered public accounting firm whose report dated May 12, 2004, except for Note 2, which is as of January 9, 2008 expressed an unqualified opinion.

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, 2008 and 2007, and confirmation of securities not held by the custodian. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements and the selected per share data and ratios referred to above present fairly, in all material respects, the consolidated financial position of Capital South-

west Corporation and subsidiaries as of March 31, 2008 and 2007, 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, 2008, and the selected per share data and ratios for each of the four years in the period ended March 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 5 to the consolidated financial statements, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, effective April 1, 2006. As described in Note 7 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, 2008.

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, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated May 23, 2008, expressed an unqualified opinion thereon.

/s/Grant Thornton LLP

Dallas, Texas
May 23, 2008

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 \$1,421,048 in 2008, \$1,187,676 in 2007 and \$257,374 in 2006. The Company also receives management fees primarily from its wholly-owned portfolio companies which aggregated \$784,800 in 2008, \$626,400 in 2007 and \$792,570 in 2006. During the three years ended March 31, 2008, the Company recorded dividend income from the following sources:

	Years Ended March 31		
	2008	2007	2006
Alamo Group Inc.	\$ 678,732	\$ 677,112	\$ 677,112
Balco, Inc.	224,400	-	252,960
Dennis Tool Company.....	62,499	62,499	49,999
Encore Wire Corporation	326,940	-	-
Kimberly-Clark Corporation	167,481	154,360	142,011
Lifemark Group	571,333	600,000	600,000
PalletOne, Inc.	-	89,842	179,685
The RectorSeal Corporation.....	1,154,133	1,869,947	1,106,893
Sprint Nextel Corporation.....	6,750	9,000	18,000
TCI Holdings, Inc.	81,270	81,270	81,270
The Whitmore Manufacturing Company .	288,533	240,000	240,000
Other	94,762	170,845	137,500
	<u>\$3,656,833</u>	<u>\$3,954,875</u>	<u>\$3,485,430</u>

Total operating expenses, excluding interest expense, increased by \$742,951 or 33.4% during the year ended March 31, 2008. 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 \$240,024 during the year ended March 31, 2008, compared with a gain of \$14,966,296 (after

income tax expense of \$11,080,699) during 2007 and a gain of \$15,450,903 (after income tax of \$4,827,663) during 2006. Management does not attempt to maintain a comparable level of realized gains from year to year, but instead attempts to maximize total investment portfolio appreciation. This strategy often dictates the long-term holding of portfolio securities in pursuit of increased values and increased unrealized appreciation, but may at opportune times dictate realizing gains or losses through the disposition of certain portfolio investments.

Net Increase in Unrealized Appreciation of Investments

For the three years ended March 31, the Company recorded a decrease in unrealized appreciation of investments of \$142,969,698, in 2008 and an increase of \$147,681,609 and \$124,355,303, in 2007 and 2006, respectively. As explained in the first paragraph of this discussion and analysis, the realization of gains or losses results in a corresponding decrease or increase in unrealized appreciation of investments. Set forth in the following table are the significant increases and decreases in unrealized appreciation 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		
	2008	2007	2006
Alamo Group Inc.	\$ (2,803,090)	\$ 2,821,000	\$ (5,642,000)
Encore Wire Corporation.....	(18,390,625)	(12,260,000)	49,041,000
Heelys, Inc.....	(160,724,088)	170,040,908	27,000,000
The Whitmore Manufacturing Company.....	12,000,000	4,000,000	4,000,000
Lifemark Group.....	31,000,000	(2,000,000)	2,000,000
Media Recovery, Inc.	(7,500,000)	3,000,000	15,744,000
Palm Harbor Homes, Inc.....	(39,275,516)	(27,493,000)	27,493,000
The RectorSeal Corporation	46,200,000	10,500,000	15,000,000

As shown in the table above for the year ended March 31, 2008, we sustained major increases in The RectorSeal Corporation, LifeMark Group and The Whitmore Manufacturing Company. The \$46,200,000

increase in RectorSeal and the \$12,000,000 increase in Whitmore were attributable to strong earnings derived from organic growth and the performance of recent acquisitions. LifeMark Group's \$31,000,000 increase is attributable to an increase in value of its cemetery and funeral home operations including the new Lifemark Center Funeral Home and continued escalations in non-business land values.

Offsetting these major increases were significant decreases in Heely's, Inc., Palm Harbor Homes, Inc., and Encore Wire Corporation. While the Heely's investment represented our largest holding at March 31, 2007, the market for Heely's stock declined during the year to a level that decreased our value by \$160,724,088. Palm Harbor's decrease of \$39,275,516 is attributable to several financial setbacks as the residual real estate markets eroded during the year. Additionally, Encore Wire experienced adversity related to the eroding residual markets and severe competition that had negative impact on its market price prompting us to decrease our value by \$18,390,625.

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, 2008."

Portfolio Investments

During the year ended March 31, 2008, the Company invested \$10,733,536 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 2007 and 2006 fiscal years, the Company invested a total of \$803,269 and \$15,054,741, respectively.

Financial Liquidity and Capital Resources

At March 31, 2008, the Company had cash and cash equivalents of approximately \$31.3 million. Pursuant to Small Business Administration (SBA) regulations, cash and cash equivalents of \$4.7 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 \$16.4 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 39 years. Retention of future gains is viewed as an important source of funds to sustain the Company's investment activity. Approximately \$52.7 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, wholly-owned portfolio companies of the Company, to the extent of their available cash reserves and borrowing capacities.

Management believes that the Company's cash and cash equivalents and cash available from other sources described above are adequate to meet its expected requirements. Consistent with the long-term strategy of the Company, the disposition of investments from time to time may also be an important source of funds for future investment activities.

Contractual Obligations

As shown below, the Company had the following contractual obliga-

tions as of March 31, 2008. For further information see Note 8 of the Consolidated Financial Statements.

Payments Due By Period (\$ in Thousands)					
		Less than	1-3	3-5	More Than
Contractual Obligations	Total	1 Year	Years	Years	5 Years
Operating lease obligations	\$393	\$80	\$240	\$73	-
Total	\$393	\$80	\$240	\$73	-

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)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Financial Position (as of March 31)											
Investments at cost	\$ 61,154	\$ 73,580	\$ 85,002	\$ 87,602	\$ 82,194	\$ 91,462	\$ 97,283	\$ 84,546	\$ 88,597	\$ 71,642	\$ 81,027
Unrealized appreciation.....	340,132	276,698	238,627	228,316	265,287	195,598	309,666	337,476	461,831	609,513	466,544
Investments at market or fair value	401,286	350,278	323,629	315,918	347,481	287,060	406,949	422,022	550,428	681,155	547,571
Total assets	522,324	360,786	392,586	322,668	357,183	298,490	423,979	434,384	569,368	729,507	586,685
Notes payable *	5,000	5,000	10,000	16,000	14,000	23,000	20,500	13,000	8,000	-	-
Net assets.....	414,697	352,974	319,438	303,436	339,891	272,211	400,157	417,947	558,036	725,732	583,700
Shares outstanding	3,788	3,815	3,815	3,815	3,829	3,829	3,857	3,857	3,860	3,886	3,889
Changes in Net Assets (years ended March 31)											
Net investment income.....	\$ 2,726	\$ 1,762	\$ 1,663	\$ 1,723	\$ 2,042	\$ 2,299	\$ 2,587	\$ 2,406	\$ 2,389	\$ 4,233	\$ 3,715
Net realized gain (loss) on investments	3,301	1,264	5,162	(5,126)	(762)	2,007	12,603	(10,112)	15,451	14,966	240
Net increase (decrease) in unrealized appreciation before distributions	106,749	(63,434)	(38,072)	(10,311)	36,971	(69,689)	114,068	27,810	124,355	147,682	(142,969)
Increase (decrease) in net assets from operations before distributions	112,776	(60,408)	(31,247)	(13,714)	38,251	(65,383)	129,258	20,104	142,195	166,881	(139,014)
Cash dividends paid	(2,268)	(2,280)	(2,289)	(2,289)	(2,295)	(2,297)	(2,309)	(2,314)	(2,314)	(2,323)	(2,333)
Employee stock options exercised	720	965	-	-	499	-	997	-	208	1,795	231
Stock option expense.....	-	-	-	-	-	-	-	-	-	169	263
Change in pension plan funded status	-	-	-	-	-	-	-	-	-	-	(1,178)
Adjustment to initially apply FASB Statement No. 158, net of tax .	-	-	-	-	-	-	-	-	-	1,173	-
Increase (decrease) in net assets	111,228	(61,723)	(33,536)	(16,003)	36,455	(67,680)	127,946	17,790	140,089	167,695	(142,031)
Per Share Data (as of March 31)											
Net assets.....	\$ 109.48	\$ 92.52	\$ 83.73	\$ 79.54	\$ 88.77	\$ 71.09	\$ 103.75	\$ 108.36	\$ 144.56	\$ 186.75	\$ 150.09
Closing market price.....	94.00	73.00	54.75	65.00	68.75	48.15	75.47	79.10	95.50	153.67	123.72
Cash dividends paid.....	.60	.60	.60	.60	.60	.60	.60	.60	.60	.60	.60

- 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, 2008. 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, 2006	\$104.45	\$ 90.65
September 30, 2006.....	121.00	96.47
December 31, 2006.....	154.36	115.33
March 31, 2007.....	155.99	122.05

<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, 2006 are as follows:

<u>Payment Date</u>	<u>Cash Dividend</u>
May 31, 2006	\$0.20
November 30, 2006	0.40
May 31, 2007	0.20
November 30, 2007	0.40
May 31, 2008	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 21, 2008, 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, 2007

Although Capital Southwest Corporation qualified to be taxed as a regulated investment company, the Company realized no taxable net long-term gains during its taxable year ended December 31, 2007. Therefore the 2007 shareholders will not need to follow the procedures used in prior years for reporting undistributed capital gains and will neither receive a tax credit nor adjust the cost basis of their shares.

For Shareholders from 1968 through 2007

In certain years from 1968 through 2007, Capital Southwest made elections to retain taxable net long-term capital gains. The table below shows the record dates for all years for which Capital Southwest 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

Professionals

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, 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.

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.