

## To Our Shareholders

Net asset value at September 30, 2009 was \$453,700,894 equivalent to \$121.26 per share. Assuming reinvestment of all dividends and tax credits on retained long-term capital gains, this represents a net asset value increase of 9.9% during the first half of the current fiscal year and a decrease of 10.8% during the past twelve months.

	September 30, 2009	September 30, 2008
Net assets .....	\$453,700,894	\$534,078,274
Shares outstanding .....	3,741,638	3,741,638
Net assets per share.....	\$121.26	\$142.74

During the six months ended September 30, 2009, unrealized appreciation of investments increased by \$37,262,293 after realizing net gains of \$1,846,516 before income taxes. This amount resulted from value increases of \$43,721,953 and value decreases of \$6,459,660. Approximately 68.4% of the value increase came from four investments: 25.9% from Alamo Group, Inc., 18.7% from Encore Wire, Inc. and 8.7% from Heelys, Inc., due to the market price increases in their respective stock prices; and 15.1% from All Components, Inc., reflecting earnings improvements from operations and the sale of a non-core business unit. Approximately 88.2% of value decrease came from two investments: 46.4% from Media Recovery, Inc., reflecting decreased earnings; and 41.8% from The RectorSeal Corporation, reflecting earnings declines in two business units.

Net realized gains for the six months ended September 30, 2009 totaled \$1,846,516 before tax provisions from the following transactions:

- A net gain of \$1,433,472 on the sale of all our shares of Dennis Tool Company, an innovator and manufacturer of polycrystalline diamond cutters (PDCs) used in oilfield drill bits and in mining and industrial applications. The reported gain does not include an additional \$659,361 held in escrow. This investment was originally made in March 1994.
- A gain of \$413,044 from Essex Capital Corporation representing a contingent payment in connection with a pre-

vious investment in PharmaFab, Inc. that was written off in 2007. Additionally, approximately \$1,000,000 in contingency payments may be recovered in the future.

A total of \$15,368,588 was invested during the past six months including \$9,000,000 in new investments and \$6,368,588 in additions to existing holdings. New venture investments include:

- iMemories, Inc. – \$4,000,000. The company provides a convenient means for consumers to maintain and share their home videos, tapes, reels and photos via a complete digitizing process. The resulting online formats can be accessed by family and friends with links to [www.imemories.com](http://www.imemories.com). The service is sold online and in selected retail outlets. The investment is in the form of convertible preferred stock representing a fully diluted potential ownership of 26.2%.
- KBI Biopharma, Inc. – \$5,000,000. This fully integrated contract biopharmaceutical development and manufacturing organization serves large pharmaceutical and biotechnology clients. The investment is Series B convertible preferred stock representing 14.8% of the fully diluted ownership.

Additions to existing investments include contracted capital calls to Ballast Point Ventures II, LP in the amount of \$150,000; BankCap Partners Fund I, LP for \$1,747,156; Cinatra Clean Technologies, Inc. for \$821,432; CMI Holding Company, Inc. for \$500,000; Discovery Alliance, LLC for \$150,000; and development financing for Palm Harbor Homes, Inc. of \$3,000,000 which was repaid during the period.

Future commitments in these holdings, subject to specific conditions, are \$2,475,000 for Ballast Point Ventures II, LP; \$486,163 for BankCap Partners Fund I, LP; \$1,270,000 for CapitalSouth Partners Fund III, LP; \$796,419 for Cinatra Clean Technologies, Inc.; \$300,000 for Discovery Alliance, LLC; and \$486,900 for Sterling Group Partners I, LP.

In addition to the Capital Southwest investment activities listed above, during the six months ended September 30, 2009 The RectorSeal Corporation, our controlled affiliate, invested \$5,100,000 in strategic acquisitions.

On October 19, 2009, our board of directors declared a dividend of \$0.40 per share, payable on November 30, 2009 to shareholders of record on November 16th. Dividends paid by our Company will be qualified dividends, taxable at a maximum rate of 15%. Our Automatic Dividend Reinvestment and Optional Cash Contribution Plan, which provides a convenient way to increase your ownership of our Company, is available to shareholders of record holding 25 or more shares. To join, call us for a brochure and authorization form.

At this time, it is probable that Capital Southwest will have a taxable net long-term capital gain for the tax year ending December 31, 2009. Our policy is to pay the tax on such gains and retain the remainder for reinvestment. By the end of February 2010, each shareholder of record will be advised of his or her share of any such net realized gains and the corresponding tax payment made by our Company. You will receive an IRS Form 2439 and detailed instructions for reporting your pro rata gain and the resulting tax credit for inclusion in your tax return. Because the applicable Federal income tax rate is 35% for corporations and 15% for individuals, most individual shareholders will receive a credit or refund. Tax-exempt entities such as IRAs will be entitled to a refund of the entire tax paid by the Company on their shares. For tax purposes, your cost basis in our stock will be increased by the amount of the after tax gain retained by the Company. For

more information, please refer to the investor section of our website, [www.capitalsouthwest.com](http://www.capitalsouthwest.com).

We are pleased to announce the following management changes intended to strengthen Capital Southwest and one of our controlled affiliates. Jeff Peterson, who joined the Company in 2001 as an Investment Associate and was promoted to Vice President in 2005, has been named President and CEO of The Whitmore Manufacturing Company, effective in November 2009. This promotion is a positive progression in Jeff's tenure at Capital Southwest. His energy and capability will serve Whitmore well as he gains operational experience within a well-run manufacturing company. In connection with this change, Ray Schwertner, the existing President and CEO of Whitmore, will assume new responsibilities at Capital Southwest as a Vice President focusing on operational matters at our controlled affiliates. Ray has been with the Whitmore organization since 1990 serving as Secretary-Treasurer through 2007 when he was promoted to the office of President. We anticipate positive contributions from these management changes.

November 5, 2009

President and Chairman

## Consolidated Portfolio of Investments – September 30, 2009

Company	Equity (a)	Investment (b)	Cost	Value (c)
<b>†ALAMO GROUP INC.</b> <b>Seguin, Texas</b> Tractor-mounted mowing and mobile excavation equipment for governmental, industrial and agricultural markets; street-sweeping equipment for municipalities.	25.3%	2,830,300 shares common stock (acquired 4-1-73 thru 5-25-07)	\$ 2,190,937	\$ 33,963,600
<b>ALL COMPONENTS, INC.</b> <b>Austin, Texas</b> Electronics contract manufacturing; distribution and production of memory and other components for computer manufacturers,retailers and value-added resellers.	80.5%	8.25% subordinated note due 2012 (acquired 6-27-07) 150,000 shares Series A Convertible Preferred Stock, convertible into 600,000 shares of common stock at \$0.25 per share (acquired 9-16-94) Warrant to purchase 350,000 shares of common stock at \$11.00 per share, expiring 2017 (acquired 6-27-07)	6,000,000  150,000  — 6,150,000	6,000,000  3,613,000  — 9,613,000
<b>ATLANTIC CAPITAL BANCSHARES, INC.</b> <b>Atlanta, Georgia</b> Holding company of Atlantic Capital Bank a full service commercial bank.	1.9%	300,000 shares common stock (acquired 4-10-07)	3,000,000	3,150,000
<b>BALCO, INC.</b> <b>Wichita, Kansas</b> Specialty architectural products used in the construction and remodeling of commercial and institutional buildings.	90.9%	445,000 shares common stock and 60,920 shares Class B non-voting common stock (acquired 10-25-83 and 5-30-02)	624,920	8,000,000
<b>BOXX TECHNOLOGIES, INC.</b> <b>Austin, Texas</b> Workstations for computer graphics imaging and design.	15.2%	3,125,354 shares Series B Convertible Preferred Stock, convertible into 3,125,354 shares of common stock at \$0.50 per share (acquired 8-20-99 thru 8-8-01)	1,500,000	2
<b>CMI HOLDING COMPANY, INC.</b> <b>Richardson, Texas</b> Owns Chase Medical, which develops and sells devices used in cardiac surgery to relieve congestive heart failure; develops and supports cardiac imaging systems.	21.2%	1,631,516 shares Series C-1 Convertible Preferred Stock, convertible into 1,631, 516 shares of common stock at \$2.15 per share (acquired 7-10-09) 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 575,975 shares of Series A-1 Convertible Preferred Stock at \$1.72 per share expiring 2017 (acquired 7-2-07) Warrant to purchase 60,174 shares of Series A-1 Convertible Preferred Stock at \$1.72 per share, expiring 2019 (acquired 6-9-09)	2,863,347  4,000,000  — — — — — 6,863,347	3,507,759  2  — — — — — 3,507,761

†Publicly-owned company

‡Unrestricted securities as defined in Note (a)

Company	Equity (a)	Investment (b)	Cost	Value (c)
<b>CINATRA CLEAN TECHNOLOGIES, INC.</b> <b>Houston, Texas</b> Cleans above ground oil storage tanks with a patented, automated system.	59.2%	10% subordinated secured promissory note (acquired 7-14-08 thru 6-16-09) 1,128,649 share Series A Convertible Preferred Stock, convertible into 1,128,649 shares common stock at \$1.00 per share (acquired 7-14-08 and 11-19-08)	\$ 5,084,432 <u>1,128,649</u> 6,213,081	\$ 5,084,432 <u>1,128,649</u> 6,213,081
† <b>ENCORE WIRE CORPORATION</b> <b>McKinney, Texas</b> Electric wire and cable for residential, commercial and industrial construction use.	17.2%	4,086,750 shares common stock (acquired 7-16-92 thru 10-7-98)	5,800,000	73,561,500
<b>EXTREME INTERNATIONAL, INC.</b> <b>Sugar Land, Texas</b> Owns Bill Young Productions, Texas Video and Post, and Extreme Communications, which produce radio and television commercials and corporate communications videos.	53.6%	13,035 shares Series A common stock (acquired 9-26-08 and 12-18-08) 39,359.18 shares Series C Convertible Preferred Stock, convertible into 157,436.72 shares of common stock at \$25.00 per share (acquired 9-30-03) 3,750 shares 8% Series A Convertible Preferred Stock, convertible into 15,000 shares of common stock at \$25.00 per share (acquired 9-30-03)	325,875 2,625,000 <u>375,000</u> 3,325,875	527,102 6,366,336 <u>606,562</u> 7,500,000
† <b>HEELYS, INC.</b> <b>Carrollton, Texas</b> Heelys stealth skate shoes, equipment and apparel sold through sporting goods chains, department stores and footwear retailers.	31.1%	9,317,310 shares common stock (acquired 5-26-00)	102,490	17,796,062
† <b>HOLOGIC, INC.</b> <b>Bedford, Massachusetts</b> Medical instruments including bone densitometers, mammography devices and digital radiography systems.	<1%	‡632,820 shares common stock (acquired 8-27-99)	220,000	10,327,622
<b>iMEMORIES, INC.</b> <b>Scottsdale, AZ</b> Enables online video and photo sharing and DVD creation for home movies recorded in analog and new digital format.	26.2%	17,391,304 shares Series B Convertible Preferred Stock, convertible into 17,391,304 shares of common at \$0.23 per share (acquired 7-10-09)	4,000,000	4,000,000
<b>KBI BIOPHARMA, INC.</b> <b>Durham, NC</b> Provides fully-intergrated, outsourced drug development and bio-manufacturing services.	14.8%	7,142,857 shares Series B-2 Convertible Preferred Stock, convertible into 7,142,857 shares of common stock at \$0.70 per share (acquired 9-08-09)	5,000,000	5,000,000
<b>LIFEMARK GROUP</b> <b>Hayward, California</b> Cemeteries, mausoleums and mortuaries located in northern California.	100.0%	1,449,026 shares common stock (acquired 7-16-69)	4,510,400	71,000,000

†Publicly-owned company

‡Unrestricted securities as defined in Note (a)

Company	Equity (a)	Investment (b)	Cost	Value (c)
<b>MEDIA RECOVERY, INC.</b> <b>Dallas, Texas</b> Computer datacenter and office automation supplies and accessories; impact, tilt monitoring and temperature sensing devices to detect mishandling shipments; dunnage for protecting shipments.	97.5%	800,000 shares Series A Convertible Preferred Stock, convertible into 800,000 shares of common stock at \$1.00 per share (acquired 11-4-97) 4,000,002 shares common stock (acquired 11-4-97)	\$ 800,000 <u>4,615,000</u> 5,415,000	\$ 2,000,000 <u>9,800,000</u> 11,800,000
<b>PALLETONE, INC.</b> <b>Bartow, Florida</b> Manufacturer of wooden pallets and pressure-treated lumber.	8.5%	12.3% senior subordinated notes due 2012 (acquired 9-25-06) 150,000 shares common stock (acquired 10-18-01) Warrant to purchase 15,294 shares of common stock at \$1.00 per share, expiring 2011 (acquired 2-17-06)	1,553,150 150,000 <u>45,746</u> 1,748,896	1,000,000 2 <u>—</u> 1,000,002
† <b>PALM HARBOR HOMES, INC.</b> <b>Dallas, Texas</b> Integrated manufacturing, retailing, financing and insuring of manufactured housing and modular homes.	32.1%	7,855,121 shares common stock (acquired 1-3-85 thru 7-31-95) Warrant to purchase 286,625 shares of common stock at \$3.14 per share, expiring 2019 (acquired 4-24-09)	10,931,955 <u>—</u> 10,931,955	9,818,902 <u>—</u> 9,818,902
<b>THE RECTORSEAL CORPORATION</b> <b>Houston, Texas</b> Specialty chemicals for plumbing, HVAC, electrical, construction, industrial, oil field and automotive applications; smoke containment systems for building fires; also owns 20% of The Whitmore Manufacturing Company.	100.0%	27,907 shares common stock (acquired 1-5-73 and 3-31-73)	52,600	104,500,000
<b>TCI HOLDINGS, INC.</b> <b>Denver, Colorado</b> Cable television systems and microwave relay systems.	—	21 shares 12% Series C Cumulative Compounding Preferred stock (acquired 1-30-90)	—	677,250
† <b>TEXAS CAPITAL BANCSHARES, INC.</b> <b>Dallas, Texas</b> Regional bank holding company with banking operations in six Texas cities.	1.4%	‡489,656 shares common stock (acquired 5-1-00)	3,550,006	8,226,221
<b>TRAX HOLDINGS, INC.</b> <b>Scottsdale, Arizona</b> Provides a comprehensive set of solutions to improve the transportation validation, accounting, payment and information management process.	32.4%	1,061,279 shares Series A Convertible Preferred Stock, convertible into 1,061,279 common stock at \$4.71 per share (acquired 12-8-08 and 2-17-09)	5,000,000	5,000,000

†Publicly-owned company

‡Unrestricted securities as defined in Note (a)

Company	Equity (a)	Investment (b)	Cost	Value (c)
<b>VIA HOLDINGS, INC.</b> <b>Sparks, Nevada</b> Designer, manufacturer and distributor of high-quality office seating.	28.1%	9,118 shares Series B Preferred Stock (acquired 9-19-05) 1,118 shares Series C Preferred Stock (acquired 11-1-07)	\$ 4,559,000 <u>281,523</u> 4,840,523	\$ 2 <u>2</u> 4
<b>WELLOGIX, INC.</b> <b>Houston, Texas</b> Developer and supporter of software used by the oil and gas industry.	19.7%	4,788,371 shares Series A-1 Convertible Participating Preferred Stock, convertible into 4,788,371 shares of common stock at \$1.10441 per share (acquired 8-19-05 thru 6-15-08)	5,000,000	2
<b>THE WHITMORE MANUFACTURING COMPANY</b> <b>Rockwall, Texas</b> Specialized surface mining, railroad and industrial lubricants; coatings for automobiles and primary metals; fluid contamination control devices.	80.0%	80 shares common stock (acquired 8-31-79)	1,600,000	38,400,000
<b>MISCELLANEOUS</b>	–	Ballast Point Ventures II, L.P. – 2.6% limited partnership interest (acquired 8-4-08 thru 4-23-09)	525,000	525,000
	–	BankCap Partners Fund I, L.P. – 6.0% limited partnership interest (acquired 7-14-06 thru 6-18-09)	5,513,837	5,513,837
	–	CapitalSouth Partners Fund III, L.P. – 2.8% limited partnership interest (acquired 1-22-08 and 2-12-09)	831,256	831,256
	–	Diamond State Ventures, L.P. – 1.9% limited partnership interest (acquired 10-12-99 thru 8-26-05)	111,000	111,000
	–	Discovery Alliance, LLC – 90.0% limited liability company (acquired 9-12-08 thru 6-1-09)	600,000	600,000
	–	Essex Capital Corporation – 10% unsecured promissory note due 8-19-10 (acquired 8-16-09)	–	1,000,000
	–	First Capital Group of Texas III, L.P. – 3.0% limited partnership interest (acquired 12-26-00 thru 8-12-05)	964,604	618,637
	100.0%	Humac Company – 1,041,000 shares common stock (acquired 1-31-75 and 12-31-75)	–	148,000
	–	STARTech Seed Fund I – 12.1% limited partnership interest (acquired 4-17-98 thru 1-5-00)	178,066	1
	–	STARTech Seed Fund II – 3.2% limited partnership interest (acquired 4-28-00 thru 2-23-05)	950,000	1
	–	Sterling Group Partners I, L.P. – 1.7% limited partnership interest (acquired 4-20-01 thru 1-24-05)	1,064,042	533,219
<b>TOTAL INVESTMENTS</b>			<b>\$98,377,835</b>	<b>\$442,935,960</b>

†Publicly-owned company

‡Unrestricted securities as defined in Note (a)

## Notes to Consolidated Portfolio of Investments (Unaudited)

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%.

### (a) Definitions

**Unrestricted securities** (indicated by  $\pm$ ) are freely marketable securities having readily available market quotations. All other securities are **restricted securities**, which are subject to one or more restriction on resale and are not freely marketable. At September 30, 2009, restricted securities represented approximately **95.8%** of the value of the consolidated investment portfolio.

### (b) Investment Valuation Policy

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

We adopted FASB ASC Topic 820 on April 1, 2008 (see footnote 3 in "Notes to Consolidated Financial Statements," page 13). ASC Topic 820 provides a framework for measuring the fair value of assets and liabilities along with guidance regarding a fair value hierarchy, which prioritizes information used to measure fair value and the effect of fair value measurements on earnings and provides for enhanced disclosures determined by the level within the hierarchy of information used for valuation. ASC Topic 820 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances.

ASC Topic 820 defines fair value in terms of the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the "exit price") and excludes transaction costs. Under ASC Topic 820, the fair value measurement also assumes that the transaction to sell an asset occurs in the principal market for the asset or, in the absence of a principal market, the most advantageous market for the asset. The principal market is the market in which the reporting entity would sell or transfer the asset with the greatest volume and level of activity for the asset. In determining the principal market for an asset or

liability under ASC, it is assumed that the reporting entity has access to the market as of the measurement date.

### (c) Valuation Methodologies

**Debt Securities** are generally valued on the basis of the price the security would command in order to provide a yield-to-maturity equivalent to the present yield of comparable debt instruments of similar quality. Issuers whose debt securities are judged to be of poor quality and doubtful collectability may instead be valued by assigning major percentage discounts commensurate with the quality of such debt securities. Debt securities may also be valued based on the resulting value from the sale of the business at the estimated fair market value.

**Partnership Interests, Preferred Equity and Common Equity** including unrestricted marketable securities, which are valued at the closing sale price for the NYSE listed securities and the lower of the closing bid price or the last sale price for NASDAQ securities on the valuation date, and restricted marketable securities for which there is a public market, are valued at the closing sale price for the NYSE listed securities and the lower of the closing bid price or the last sale price for NASDAQ securities on the valuation date adjusted in good faith by our Board of Directors if they deem a discount or premium would be likely or obtainable upon a sale or transfer of our interest. For those without a principal market, the Board of Directors considers the financial condition and operating results of the issuer; the long-term potential of the business of the issuer; the market for and recent sales prices of the issuer's securities; the values of similar securities issued by companies in similar businesses; the proportion of the issuer's securities owned by the Company; protective put analysis based on the Black-Scholes option pricing model; the nature and duration of resale restrictions; and the nature of any rights enabling the Company to require the issuer to register restricted securities under applicable securities laws. In determining the fair value of restricted securities, the Board of Directors considers the inherent value of such securities without regard to the restrictive feature and adjusts for any diminution in value resulting from restrictions on resale.

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

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

<b>Assets</b>	September 30 2009 <u>(Unaudited)</u>	March 31 2009 <u>(Unaudited)</u>	<b>Liabilities</b>	September 30 2009 <u>(Unaudited)</u>	March 31 2009 <u>(Unaudited)</u>
Investments at market or fair value			Other liabilities .....	\$ 951,400	\$ 253,294
Companies more than 25% owned			Pension liability .....	958,715	934,427
(Cost: September 30, 2009 –			Deferred income taxes .....	<u>1,651,852</u>	<u>1,092,427</u>
\$26,028,302, March 31, 2009 –			Total liabilities .....	<u>3,561,967</u>	<u>2,280,148</u>
\$29,208,246) .....	\$299,954,124	\$286,488,248			
Companies 5% to 25% owned			<b>Net Assets</b>		
(Cost: September 30, 2009 –			Common stock, \$1 par value: authorized,		
\$20,912,243, March 31, 2009 –			5,000,000 shares; issued, 4,326,516		
\$20,412,243) .....	78,069,267	66,388,010	shares at September 30, 2009 and		
Companies less than 5% owned			March 31, 2009 .....	4,326,516	4,326,516
(Cost: September 30, 2009 –			Additional capital .....	124,590,664	124,571,029
\$51,437,290, March 31, 2009 –			Undistributed net investment income .....	2,273,099	2,963,640
\$39,718,702) .....	<u>68,840,129</u>	<u>43,758,765</u>	Undistributed net realized gain on		
Total investments			investments .....	1,889,138	42,622
(Cost: September 30, 2009 –			Unrealized appreciation of investments .....	344,558,125	307,295,832
\$98,377,835, March 31, 2009 –			Treasury stock – at cost 584,878 shares at		
\$89,339,191) .....	442,935,960	396,635,023	September 30, 2009 and March 31, 2009.	<u>(23,936,648)</u>	<u>(23,936,648)</u>
Cash and cash equivalents .....	6,744,329	14,721,730	Total net assets .....	<u>453,700,894</u>	<u>415,262,991</u>
Receivables			Total liabilities and net assets .....	<u>\$457,262,861</u>	<u>\$417,543,139</u>
Dividends and interest .....	732,324	498,506	Net asset value per share		
Affiliates .....	1,011,983	16,706	(on the 3,741,638 shares outstanding) .....	<u>\$ 121.26</u>	<u>\$ 110.98</u>
Pension assets .....	5,677,703	5,468,861			
Other assets .....	<u>160,562</u>	<u>202,313</u>			
Totals Assets .....	<u>\$457,262,861</u>	<u>\$417,543,139</u>			

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

	Three Months Ended September 30		Six Months Ended September 30	
	2009	2008	2009	2008
Investment income:				
Interest.....	\$ 189,446	\$ 327,171	\$ 512,254	\$ 677,023
Dividends.....	613,232	677,999	1,197,602	1,335,479
Management and directors' fees.....	260,350	311,108	543,100	542,108
	<u>1,063,028</u>	<u>1,316,278</u>	<u>2,252,956</u>	<u>2,554,610</u>
Operating expenses:				
Salaries.....	495,276	439,480	951,332	777,919
Net pension benefit .....	(121,248)	(44,779)	(184,554)	(126,617)
Other operating expenses .....	291,930	435,192	622,630	804,437
	<u>665,958</u>	<u>829,893</u>	<u>1,389,408</u>	<u>1,455,739</u>
Income before income taxes .....	397,070	486,385	863,548	1,098,871
Income tax expense .....	35,234	57,343	57,434	84,630
<b>Net investment income.....</b>	<u>\$ 361,836</u>	<u>\$ 429,042</u>	<u>\$ 806,114</u>	<u>\$ 1,014,241</u>
Proceeds from disposition of investments .....	\$ 5,176,460	\$ -	\$ 5,176,460	\$ -
Cost of investments sold.....	<u>3,329,944</u>	<u>48,041</u>	<u>3,329,944</u>	<u>48,041</u>
<b>Net realized gain (loss) on investments .....</b>	<u>1,846,516</u>	<u>(48,041)</u>	<u>1,846,516</u>	<u>(48,041)</u>
<b>Net increase (decrease) in unrealized appreciation of investments .....</b>	<u>27,013,023</u>	<u>(30,970,122)</u>	<u>37,262,293</u>	<u>(31,227,236)</u>
<b>Net realized and unrealized gain (loss) on investments .....</b>	<u>\$28,859,539</u>	<u>\$(31,018,163)</u>	<u>\$39,108,809</u>	<u>\$(31,275,277)</u>
<b>Increase (decrease) in net assets from operations .....</b>	<u>\$29,221,375</u>	<u>\$(30,589,121)</u>	<u>\$39,914,923</u>	<u>\$(30,261,036)</u>

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

	<u>Six Months Ended</u> <u>September 30, 2009</u>	<u>Six Months Ended</u> <u>September 30, 2008</u>
Operations		
Net investment income .....	\$ 806,114	\$ 1,014,241
Net realized gain (loss) on investments .....	1,846,516	(48,041)
Net increase (decrease) in unrealized appreciation of investments .....	<u>37,262,293</u>	<u>(31,227,236)</u>
Increase (decrease) in net assets from operations .....	39,914,923	(30,261,036)
Distributions from:		
Undistributed net investment income .....	(1,496,655)	(2,678,152)
Capital share transactions:		
Change in pension plan funded status .....	(263,416)	—
Stock option expense .....	283,051	220,594
Treasury stock .....	<u>—</u>	<u>(16,903,346)</u>
Increase (decrease) in net assets .....	38,437,903	(49,621,940)
Net assets, beginning of period.....	<u>415,262,991</u>	<u>583,700,214</u>
<b>Net assets, end of period.....</b>	<b><u>\$453,700,894</u></b>	<b><u>\$ 534,078,274</u></b>

## Capital Southwest Corporation and Subsidiaries

### Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended September 30		Six Months Ended September 30	
	2009	2008	2009	2008
<b>Cash flows from operating activities</b>				
Increase (decrease) in net assets from operations .....	\$29,221,375	\$(30,589,121)	\$ 39,914,923	\$(30,261,036)
Adjustments to reconcile increase in net assets from operations to net cash provided by operating activities:				
Proceeds from disposition of investments .....	5,176,459	—	5,176,459	—
Proceeds from repayment of debt security .....	—	—	3,000,000	—
Purchases of securities .....	(9,405,000)	(3,994,279)	(15,368,588)	(4,103,820)
Depreciation and amortization .....	7,245	10,638	14,898	19,907
Net pension benefit .....	(121,248)	(44,780)	(184,554)	(126,617)
Realized (gain) loss on investments .....	(1,846,516)	48,041	(1,846,516)	48,041
Net (increase) decrease in unrealized appreciation of investments .....	(27,013,023)	30,970,122	(37,262,293)	31,227,236
Stock option expense .....	141,526	132,605	283,051	220,594
Increase in dividend and interest receivable .....	62,048	(101,876)	(233,818)	(122,632)
Increase in receivables from affiliates .....	(726,662)	(341,004)	(764,067)	(344,384)
Increase (decrease) in other assets .....	19,977	(26,325)	26,853	(23,747)
Increase (decrease) in other liabilities .....	665,853	(497,383)	698,106	22,992
Decrease in accrued pension cost .....	—	(34,467)	—	(68,934)
Increase in deferred income taxes .....	42,600	15,800	64,800	44,300
Net cash used in operating activities .....	<u>(3,775,366)</u>	<u>(4,452,029)</u>	<u>(6,480,746)</u>	<u>(3,468,100)</u>
<b>Cash flows from financing activities</b>				
Distributions from undistributed net investment income .....	—	—	(1,496,655)	(1,555,660)
Purchase of treasury stock .....	—	(16,178,867)	—	(16,903,346)
Net cash used in financing activities .....	<u>—</u>	<u>(16,178,867)</u>	<u>(1,496,655)</u>	<u>(18,459,006)</u>
Net decrease in cash and cash equivalents .....	(3,775,366)	(20,630,896)	(7,977,401)	(21,927,106)
Cash and cash equivalents at beginning of period .....	10,519,695	30,031,548	14,721,730	31,327,758
Cash and cash equivalents at end of period .....	<u>\$ 6,744,329</u>	<u>\$ 9,400,652</u>	<u>\$ 6,744,329</u>	<u>\$ 9,400,652</u>
<b>Supplemental disclosure of cash flow information</b>				
Cash paid during the period for:				
Interest .....	\$ —	\$ —	\$ —	\$ —
Income taxes .....	\$ —	\$ —	\$ —	\$ —

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

	Three Months Ended September 30 (unaudited)		Six Months Ended September 30 (unaudited)		Years Ended March 31			
	2009	2008	2009	2008	2009	2008	2007	2006
<b>Per Share Data</b>								
Investment income.....	\$ .28	\$ .35	\$ .60	\$ .68	\$ 3.74	\$ 1.75	\$ 1.79	\$ 1.25
Operating expenses.....	(.17)	(.22)	(.37)	(.39)	(.98)	(.76)	(.57)	(.51)
Interest expense.....	-	-	-	-	-	-	(.12)	(.11)
Income taxes.....	(.01)	(.02)	(.01)	(.02)	(.04)	(.03)	(.01)	(.01)
Net investment income.....	.10	.11	.22	.27	2.72	.96	1.09	.62
Distributions from undistributed net investment income.....	-	(.30)	(.40)	(.72)	(3.28)	(.60)	(.60)	(.60)
Net realized gain (loss) on investments.....	.49	(.01)	.49	(.01)	2.87	.06	3.85	4.00
Net increase (decrease) in unrealized appreciation of investments.....	7.22	(8.28)	9.96	(8.35)	(42.56)	(36.76)	38.00	32.22
Treasury stock repurchase *.....	-	1.33	-	1.40	-	-	-	-
Exercise of employee stock options **.....	-	-	-	-	-	(.09)	(.49)	(.04)
Stock option expense.....	.04	.04	.08	.06	.13	.07	.04	-
Net change in pension plan funded status.....	-	-	(.07)	-	(.39)	(.30)	-	-
Treasury Stock.....	-	-	-	-	1.40	-	-	-
Adjustment to initially apply FASB No. 158, net of tax.....	-	-	-	-	-	-	.30	-
Increase (decrease) in net asset value.....	7.85	(7.11)	10.28	(7.35)	(39.11)	(36.66)	42.19	36.20
Net asset value:								
Beginning of period.....	<u>113.41</u>	<u>149.85</u>	<u>110.98</u>	<u>150.09</u>	<u>150.09</u>	<u>186.75</u>	<u>144.56</u>	<u>108.36</u>
End of period.....	<u>\$121.26</u>	<u>\$142.74</u>	<u>\$121.26</u>	<u>\$142.74</u>	<u>\$110.98</u>	<u>\$150.09</u>	<u>\$186.75</u>	<u>\$144.56</u>
Shares outstanding at end of period (000s omitted).....	3,742	3,742	3,742	3,742	3,741	3,889	3,886	3,860

\* Net increase is due to purchase of Common Stock at prices less than beginning of period net asset value.

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

## 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.

## Officers

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

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

**Jeffrey G. Peterson**, Vice President and Valuation Manager, joined Capital Southwest in 2001. Previously, he was employed in the investment banking departments 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 Johnson Graduate School of Management at Cornell University and a BBA from the University of Texas at Austin.

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

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