

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

CAPITAL SOUTHWEST CORP  
Form 10-Q  
February 08, 2008

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from .....to .....

Commission File Number: 814-61

CAPITAL SOUTHWEST CORPORATION  
(Exact name of registrant as specified in its charter)

Texas  
(State or other jurisdiction of incorporation  
or organization)

75-1072796  
(I.R.S. Employer  
Identification No.)

12900 Preston Road, Suite 700, Dallas, Texas  
(Address of principal executive offices)

75230  
(Zip Code)

Registrant's telephone number, including area code: (972) 233-8242

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No  
-----

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ----- Accelerated filer X ----- Non-accelerated filer -----

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ----- No X -----

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

3,889,151 shares of Common Stock, \$1 Par Value as of January 31, 2008

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(1) As described in Note 2, the financial statements for fiscal year 2007 have been restated.

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

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### CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES Consolidated Statements of Financial Condition

Assets	December 31, 2007 ----- (Unaudited)	March 31, 2007 ----- as restated
Investments at market or fair value		
Companies more than 25% owned		
(Cost: December 31, 2007 - \$28,758,246		
March 31, 2007 - \$28,632,356)	\$ 362,231,558	\$ 526,993,983
Companies 5% to 25% owned		
(Cost: December 31, 2007 - \$20,412,243,		
March 31, 2007 - \$18,798,896)	48,765,256	76,398,002
Companies less than 5% owned		
(Cost: December 31, 2007 - \$31,190,721,		
March 31, 2007 - \$24,211,045)	93,097,989	77,763,048
	-----	-----
Total investments		
(Cost: December 31, 2007- \$80,361,210,		
March 31, 2007 - \$71,642,297)	504,094,803	681,155,033
Cash and cash equivalents	31,949,168	38,844,203
Receivables	258,171	337,892
Other assets	9,477,698	9,170,185
	-----	-----
Totals	\$ 545,779,840	\$ 729,507,313
	=====	=====
 Liabilities and Shareholders' Equity		
Other liabilities	\$ 1,452,545	\$ 1,457,847
Deferred income taxes	2,403,277	2,317,777
	-----	-----
Total liabilities	3,855,822	3,775,624
	-----	-----
Shareholders' equity		
Common stock, \$1 par value: authorized,		
5,000,000 shares; issued, 4,326,516 shares		
at December 31, 2007 and 4,323,416 shares		
at March 31, 2007	4,326,516	4,323,416
Additional capital	116,777,926	116,373,960
Undistributed net investment income	6,979,403	5,655,020
Undistributed net realized loss on investments	(2,860,118)	(3,100,142)
Unrealized appreciation of investments	423,733,593	609,512,737
Treasury stock - at cost (437,365 shares)	(7,033,302)	(7,033,302)
	-----	-----
Net assets at market or fair value, equivalent		
to \$139.34 per share at December 31, 2007		
on the 3,889,151 shares outstanding and \$186.75		
per share at March 31, 2007 on the 3,886,051		
shares outstanding	541,924,018	725,731,689
	-----	-----
Totals	\$ 545,779,840	\$ 729,507,313
	=====	=====

(See Notes to Consolidated Financial Statements)

CAPITAL SOUTHWEST CORPORATION  
AND SUBSIDIARIES  
Consolidated Statements of Operations

-----  
(Unaudited)

	Three Months Ended December 31		Nine Months Ended December 31	
	2007	2006	2007	2006
		as restated		
	-----	-----	-----	-----
Investment income:				
Interest	\$ 552,950	\$ 484,888	\$ 1,797,079	\$ 1,797,079
Dividends	1,838,757	1,626,702	3,003,651	3,003,651
Management and directors' fees	222,449	163,750	673,849	673,849
	-----	-----	-----	-----
	2,614,156	2,275,340	5,474,579	5,474,579
	-----	-----	-----	-----
Operating expenses:				
Salaries	380,247	310,127	945,468	945,468
Net pension benefit	(81,837)	(36,237)	(245,508)	(245,508)
Other operating expenses	481,128	238,504	1,034,286	1,034,286
	-----	-----	-----	-----
	779,538	512,394	1,734,246	1,734,246
	-----	-----	-----	-----
Income before interest expense and income taxes	1,834,618	1,762,946	3,740,333	3,740,333
Interest expense	--	133,749	--	--
	-----	-----	-----	-----
Income before income taxes	1,834,618	1,629,197	3,740,333	3,740,333
Income tax expense	28,500	12,700	82,660	82,660
	-----	-----	-----	-----
Net investment income	\$ 1,806,118	\$ 1,616,497	\$ 3,657,673	\$ 3,657,673
	=====	=====	=====	=====
Proceeds from disposition of investments	\$ 670,339	\$ 31,578,052	\$ 1,398,891	\$ 1,398,891
Cost of investments sold	1,158,868	12,046,678	1,158,868	1,158,868
	-----	-----	-----	-----
Net realized gain (loss) on investments before taxes	(488,528)	19,531,374	240,024	240,024
Income tax expense	--	11,080,699	--	--
	-----	-----	-----	-----
Net realized gain (loss) on investments	(488,528)	8,450,675	240,024	240,024
	-----	-----	-----	-----
Net increase (decrease) in unrealized appreciation of investments	(64,798,599)	132,210,244	(185,779,143)	(185,779,143)
	-----	-----	-----	-----
Net realized and unrealized gain (loss)				

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on investments	\$ (65,287,127)	\$ 140,660,919	\$ (185,539,119)	\$ 1
	=====	=====	=====	=====
Increase (decrease) in net assets from operations	\$ (63,481,009)	\$ 142,277,416	\$ (181,881,446)	\$ 1
	=====	=====	=====	=====

(See Notes to Consolidated Financial Statements)

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CAPITAL SOUTHWEST CORPORATION  
AND SUBSIDIARIES  
Consolidated Statements of Changes in Net Assets  
-----

	Nine Months Ended December 31, 2007	Year Ended March 31, 2007
	----- (Unaudited)	----- as restated
Operations		
Net investment income	\$ 3,657,673	\$ 4,233,340
Net realized gain on investments	240,024	14,966,296
Net increase (decrease) in unrealized appreciation of investments	(185,779,143)	147,681,609
	-----	-----
Increase (decrease) in net assets from operations	(181,881,446)	166,881,245
Distributions from:		
Undistributed net investment income	(2,333,291)	(2,323,150)
Net realized gains deemed distributed to shareholders	--	(11,417,283)
Capital share transactions		
Allocated increase in share value for deemed distribution	--	11,417,283
Exercise of employee stock options	231,390	1,794,850
Adjustment to initially apply FASB No. 158, net of tax	--	1,173,751
Stock option expense	175,676	169,003
	-----	-----
Increase (decrease) in net assets	(183,807,671)	167,695,699
Net assets, beginning of period as restated	725,731,689	558,035,990
	-----	-----
Net assets, end of period	\$ 541,924,018	\$ 725,731,689
	=====	=====

(See Notes to Consolidated Financial Statements)

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CAPITAL SOUTHWEST CORPORATION  
AND SUBSIDIARIES  
Consolidated Statements of Cash Flows

-----  
(Unaudited)

	Three Months Ended December 31		Nin D
	2007	2006	2007
	-----	-----	-----
		as restated	
Cash flows from operating activities			
Increase (decrease) in net assets from operations	\$ (63,481,009)	\$ 142,277,416	\$ (181,881,4
Adjustments to reconcile increase in net assets from operations to net cash provided by (used in ) operating activities:			
Proceeds from disposition of investments	670,339	31,578,052	1,398,8
Purchases of securities	(817,186)	(4,500)	(10,032,2
Maturities of securities	--	--	154,5
Depreciation and amortization	8,089	4,426	18,7
Net pension benefit	(81,837)	(36,237)	(245,5
Realized (gain) loss on investments after income taxes	488,528	(8,450,675)	(240,0
Net (increase) decrease in unrealized appreciation of investments	64,798,599	(132,210,244)	185,779,1
Stock option expense	87,989	43,586	175,6
(Increase) decrease in receivables	(155,215)	(105,087)	79,7
(Increase) decrease in other assets	(11,451)	3,391	(41,8
Increase (decrease) in other liabilities	132,468	38,330	57,0
Decrease in accrued pension cost	(34,467)	(36,567)	(101,3

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Increase in deferred income taxes	28,500	12,700	85,5
	-----	-----	-----
Net cash provided by (used in) operating activities	1,633,347	33,114,591	(4,793,1
	-----	-----	-----
Cash flows from financing activities			
Decrease in notes payable to bank	--	--	--
Distributions from undistributed net investment income	(1,555,661)	(1,551,100)	(2,333,2
Proceeds from exercise of employee stock options	--	697,350	231,3
	-----	-----	-----
Net cash used in financing activities	(1,555,661)	(853,750)	(2,101,9
	-----	-----	-----
Net increase (decrease) in cash and cash equivalents	77,686	32,260,841	(6,895,0
Cash and cash equivalents at beginning of period	31,871,482	24,269,495	38,844,2
	-----	-----	-----
Cash and cash equivalents at end of period	\$ 31,949,168	\$ 56,530,336	\$ 31,949,1
	=====	=====	=====
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Interest	\$ --	\$ 133,749	\$ --
Income taxes	\$ --	\$ --	\$ --

(See Notes to Consolidated Financial Statements)

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CAPITAL SOUTHWEST CORPORATION  
AND SUBSIDIARIES  
Consolidated Statement of Investments

-----  
December 31, 2007

Company	Investment (a)
-----	
+AT&T INC. San Antonio, Texas Global leader in local, long distance, Internet and transaction-based voice and data services.	+20,770 shares common stock (acquired 3-9-99)
+ALAMO GROUP INC. Sequin, Texas Tractor-mounted mowing and	2,830,300 shares common stock (acquired 4-1-73 thru 5-25-07)

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mobile excavation equipment  
for governmental, industrial  
and agricultural markets;  
street-sweeping equipment  
for municipalities.

<p>ALL COMPONENTS, INC. Austin, Texas Electronics contract manu- facturing; distribution and production of memory and other components for computer manufacturers, retailers and value-added resellers.</p>	<p>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)</p>
<p>+ATLANTIC CAPITAL BANCSHARES, INC. Atlanta, Georgia Holding company of Atlantic Capital Bank a full service commercial bank.</p>	<p>300,000 shares common stock (acquired 4-10-07)</p>
<p>BALCO, INC. Wichita, Kansas Specialty architectural products used in the construction and remodeling of commercial and insti- tutional buildings.</p>	<p>445,000 shares common stock and 60,920 shares Class B non-voting common stock (acquired 10-25-83 and 5-30-02)</p>
<p>BOXX TECHNOLOGIES, INC. Austin, Texas Workstations for computer graphics imaging and design.</p>	<p>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)</p>
<p>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.</p>	<p>10% convertible subordinate note, due 2009 (acquired 7- 2,327,658 shares Series A convertible preferred stock, convertible into 2,327,658 shares of common stock at \$1.72 per share (acquired 8-21-02 and 6-4-03) Warrants to purchase 109,012 shares of common stock at \$1.72 per share, expiring 2012 (acquired 4-16-04) Warrants to purchase 431,982 shares of Series A-1 convertible preferred stock at \$1.72 per share expiring 2012 (acquired 7-2-07)</p>

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CAPITAL SOUTHWEST CORPORATION  
AND SUBSIDIARIES  
Consolidated Statement of Investments  
-----

December 31, 2007  
(continued)

Company

Investment (a)



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+COMCAST CORPORATION Philadelphia, Pennsylvania Leading provider of cable, entertainment and communi- cations products and services.	++64,656 shares common stock (acquired 11-18-02)
DENNIS TOOL COMPANY Houston, Texas Polycrystalline diamond compacts (PDCs) used in oil field drill bits and in mining and industrial applications.	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 8-10-94)
+DISCOVERY HOLDING COMPANY Englewood, Colorado Provider of creative content, media management and network services worldwide.	++70,501 shares Series A common stock (acquired 7-21-05)
+EMBARQ CORPORATION Overland Park, Kansas Local exchange carrier that provides voice and data services, including high-speed Internet.	++4,500 shares common stock (acquired 5-17-06)
+ENCORE WIRE CORPORATION McKinney, Texas Electric wire and cable for residential and commercial use.	4,086,750 shares common stock (acquired 7-16-92 thru 10-1-92)
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.	39,359.18 shares Series C convertible preferred stock, convertible into 157,436.72 shares of common stock at \$29.00 per share (acquired 9-30-03) 3,750 shares 8% Series A convertible preferred stock, convertible into 15,000 shares of common stock at \$29.00 per share (acquired 9-30-03) Warrants to purchase 13,035 shares of common stock at \$29.00 per share, expiring 2008 (acquired 8-11-98 thru 9-30-03)
+FMC CORPORATION Philadelphia, Pennsylvania Chemicals for agricultural, industrial and consumer markets.	++12,860 shares common stock (acquired 6-6-86 and 9-13-86)
+FMC TECHNOLOGIES, INC. Houston, Texas Equipment and systems for the energy, food processing and air transportation industries.	++22,114 shares common stock (acquired 1-2-02 and 8-31-02)

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CAPITAL SOUTHWEST CORPORATION  
AND SUBSIDIARIES  
Consolidated Statement of Investments

December 31, 2007  
(continued)

Company	Investment (a)
+HEELYS, INC. Carrollton, Texas Heelys stealth skate shoes, equipment and apparel sold through sporting goods chains, department stores and footwear retailers.	9,317,310 shares common stock (acquired 5-26-00)
+HOLOGIC, INC. Bedford, Massachusetts Medical instruments including bone densi- tometers, mammography devices and digital radiography systems.	++316,410 shares common stock (acquired 8-27-99)
+KIMBERLY-CLARK CORPORATION Dallas, Texas Manufacturer of tissue, personal care and health care products.	++77,180 shares common stock (acquired 12-18-97)
+LIBERTY GLOBAL, INC. Englewood, Colorado Owns interests in broadband, distribution and content companies.	++42,463 shares Series A common stock (acquired 6-15-05) ++42,463 shares Series C common stock (acquired 9-6-05)
+LIBERTY MEDIA CORPORATION Englewood, Colorado Holding company owning interests in electronic retailing, media, communi- cations and entertainment businesses.	++35,250 shares of Liberty Capital Series A common stock (acquired 5-9-06) ++176,252 shares of Liberty Interactive Series A common (acquired 5-9-06)
LIFEMARK GROUP Hayward, California Cemeteries, mausoleums and mortuaries located in northern California.	1,449,026 shares common stock (acquired 7-16-69)
MEDIA RECOVERY, INC. Dallas, Texas Computer datacenter and office automation supplies	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)

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and accessories; impact, tilt monitoring and temperature sensing devices to detect mishandled shipments; dunnage for protecting shipments.

PALLETONE, INC. Bartow, Florida Manufacturer of wooden pallets and pressure-treated lumber.	12.3% senior subordinated notes due 2012 (acquired 9-2-06) 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)
---	--

+PALM HARBOR HOMES, INC. Dallas, Texas Integrated manufacturing, retailing, financing and insuring of manufactured housing and modular homes.	7,855,121 shares common stock (acquired 1-3-85 thru 7-3-06)
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CAPITAL SOUTHWEST CORPORATION  
AND SUBSIDIARIES  
Consolidated Statement of Investments

-----  
December 31, 2007  
(continued)

Company	Investment (a)
+PETSMART, INC. Phoenix, Arizona Retail chain of more than 928 stores selling pet foods, supplies and services.	++300,000 shares common stock (acquired 6-1-95)
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.	27,907 shares common stock (acquired 1-5-73 and 3-31-73)
+SPRINT NEXTEL CORPORATION Reston, Virginia Diversified telecommunications company.	++90,000 shares common stock (acquired 6-20-84)
TCI HOLDINGS, INC. Denver, Colorado	21 shares 12% Series C cumulative compounding preferred stock (acquired 1-30-90)

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Cable television systems and  
microwave relay systems.

<p>+TEXAS CAPITAL BANCSHARES, INC. Dallas, Texas Regional bank holding company with banking operations in six Texas cities.</p>	<p>++489,656 shares common stock (acquired 5-1-00)</p>
<p>VIA HOLDINGS, INC. Sparks, Nevada Designer, manufacturer and distributor of high-quality office seating.</p>	<p>9,118 shares Series B preferred stock (acquired 9-19-05) 1,118 shares Series C preferred stock (acquired 11-01-05)</p>
<p>WELLOGIX, INC. Houston, Texas Developer and supporter of software used by the oil and gas industry to control drilling and maintenance expenses.</p>	<p>4,664,627 shares Series A-1 convertible participating preferred stock, convertible into 4,664,627 shares of common stock at \$1.1011 per share (acquired 8-19-05 thru 12-15-07)</p>
<p>THE WHITMORE MANUFACTURING COMPANY Rockwall, Texas Specialized mining, railroad and industrial lubricants; coatings for automobiles and primary metals; fluid contamination control devices.</p>	<p>80 shares common stock (acquired 8-31-79)</p>
<p>+WINDSTREAM CORPORATION Little Rock, Arkansas Provider of voice, broadband and entertainment services.</p>	<p>++9,181 shares common stock (acquired 7-17-06)</p>

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CAPITAL SOUTHWEST CORPORATION  
AND SUBSIDIARIES  
Consolidated Statement of Investments

-----  
December 31, 2007  
(continued)

Company	Investment (a)
-----	
MISCELLANEOUS	<ul style="list-style-type: none"> <li>- BankCap Partners Fund I, L.P. - 6.0% limited partnership interest (acquired 7-14-06 thru 12-21-07)</li> <li>- Diamond State Ventures, L.P. - 1.9% limited partnership interest (acquired 10-12-99 thru 8-26-05)</li> <li>- First Capital Group of Texas III, L.P. - 3.3%</li> </ul>

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- limited partnership interest (acquired 12-26-00 thru 8-12-05)
- Humac Company - 1,041,000 shares common stock (acquired 1-31-75 and 12-31-75)
- PharmaFab, Inc. - contingent payment agreement (acquired 2-15-07)
- STARTech Seed Fund I - 12.1% limited partnership interest (acquired 4-17-98 thru 1-5-00)
- STARTech Seed Fund II - 3.2% limited partnership interest (acquired 4-28-00 thru 2-23-05)
- Sterling Group Partners I, L.P. - 1.7% limited partnership interest (acquired 4-20-01 thru 1-24-05)

-----  
TOTAL INVESTMENTS

-----  
+Publicly-owned company

++ Unrestricted securities as defined in Note (a)

Notes to Portfolio of Investments  
-----

(a) 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 December 31, 2007, restricted securities represented approximately 87.9% of the value of the consolidated investment portfolio.

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

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

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-----  
(Unaudited)

## 1. Basis of Presentation

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.

The financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and Article 6 of Regulation S-X. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Form 10-K/A for the year ended March 31, 2007. Certain information and footnotes normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted, although we believe that the disclosures are adequate for a fair presentation. The information reflects all adjustments (consisting of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the results of operations for the interim periods.

## 2. Restatement of Consolidated Financial Statements

Capital Southwest Corporation (the "Company") filed an amendment to its Annual Report on Form 10-K for the year ended March 31, 2007, to amend and restate its consolidated financial statements and selected per share data and ratios for each of the fiscal years ended March 31, 2007, 2006 and 2005 and our selected per share data and ratios for the years ended March 31, 2004 and 2003. In addition, we filed an amendment to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2007.

After reviewing the accounting treatment for deferred taxes on realized appreciation of investments, the Company has determined its long-standing policy of recording deferred taxes on unrealized appreciation of investments was not in conformity with generally accepted accounting principles and its previously issued financial statements required restatement. The effect of the restatement on the consolidated statement of financial conditions as of March 31, 2007; the consolidated statement of operations and consolidated statement of cash flows for the three months and nine months ended December 31, 2006; the consolidated statement of changes in net assets for the nine months ended December 31, 2006 and year ended March 31, 2007 is as follows and shown in tables below:

- (A) A Regulated Investment Company (RIC) is required to record deferred taxes when it is probable the RIC will not qualify under Subchapter M of the Internal Revenue Code for a period longer than one year. Historically, management believed it was probable the Company would not maintain its qualifying status as a RIC in future years and recorded a deferred tax liability on the unrealized appreciation of investments. However, upon further analysis, the Company determined it was only reasonably possible, but not probable, the Company would not maintain its qualifying status as a RIC. Thus the deferred tax liability consistently recorded and disclosed should not have been recognized.
- (B) The Company historically has accrued income taxes payable on its investment gains as they have been incurred, as it has been the Company's practice to retain its investment gains. However, RICs are required to accrue federal

Notes to Consolidated Financial Statements  
(continued)

income taxes on investment gains that are retained only on the last day of the tax year. The Company incorrectly recorded the tax impact of its investment gains in periods other than the last day of its tax year, December 31. Therefore, the income taxes payable recorded at times other than the tax year end should not have been recognized.

- (C) The Company incorrectly classified its' return of capital contributions cumulatively as "undistributed net realized gains on investments." RICs are required to classify return of capital contributions as "additional capital" in the period in which tax basis amounts become permanent; and reflect undistributed amounts remaining since its' previous tax year end adjusted for temporary tax basis differences as "undistributed net realized gains on investment."

The restatement will eliminate the accrual for deferred taxes on unrealized appreciation of investments, and income taxes payable and related tax carryforwards on realized gains, increasing the net asset value per share and net assets from operations for the periods restated; reclassify return of capital contributions to "additional capital."

	As of March 31, 2007 -----	
Consolidated Statement of Financial Condition -----	Previously Reported (3) -----	As Restated (2) -----
Total assets	729,507,313 =====	729,507,313 =====
Income taxes payable	231,274	-- (B)
Deferred income tax	213,474,680 -----	2,317,777 (A) (B) -----
Total liabilities	215,163,801 -----	3,775,624 -----
Additional capital	11,221,601	116,343,960 (C)
Undistributed net realized gains (losses)	102,766,040	(3,100,142) (B) (C)
Net unrealized appreciation of investments	397,410,737	609,512,737 (A)
Net assets at market or fair value	514,343,512 -----	725,731,689 -----
Total liabilities and shareholders equity	729,507,313 =====	729,507,313 =====
	Nine Months Ended December 31, 2006 -----	
Consolidated Statement of Operations -----	Previously Reported (1) -----	As Restated (2) -----
Net investment income	3,278,407	3,278,407

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Net realized gain on investments	29,147,137	29,147,137	(B)
Income tax expense	10,098,046	11,080,699	
	-----	-----	
Net realized gain on investments	19,049,091	18,066,438	
Increase in unrealized appreciation of investments	124,061,543	124,061,543	(A)
Increase in deferred income taxes on appreciation of investments	43,017,000	--	
	-----	-----	
Net increase in unrealized appreciation of investments	81,044,543	124,061,543	
Net realized and unrealized gain on investments	100,093,634	142,127,981	
	-----	-----	
Increase in net assets from operations	103,372,041	145,406,388	
	=====	=====	

Three Months Ended December 31, 2006

Consolidated Statement of Operations	Previously Reported (1)	As Restated (2)	
-----	-----	-----	
Net investment income	1,616,497	1,616,497	
Net realized gain on investments	12,805,347	8,450,675	(B)
Net decrease in unrealized appreciation of investments	86,187,244	132,210,244	(A)
	-----	-----	
Net realized and unrealized gain on investments	98,992,591	140,660,919	
	-----	-----	
Increase in net assets from operations	100,609,088	142,277,416	
	=====	=====	

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Notes to Consolidated Financial Statements  
(continued)

	Year Ended March 31, 2007		
	Previously Reported (3)	As Restated (2)	
Consolidated Statement of Changes in Net Assets	-----	-----	
-----	-----	-----	
Net investment income	4,233,340	4,233,340	
Net realized gain on investments	16,334,000	14,966,296	(B)
Net increase on unrealized appreciation before distributions	96,343,609	147,681,609	(A)
	-----	-----	
Increase in net assets from operations before distributions	116,910,949	166,881,245	
Undistributed net investment income	(2,323,150)	(2,323,150)	
Net realized gains deemed distributed to shareholders	--	(11,417,283)	(C)
	-----	-----	
Allocated increase in share value for deemed distribution	--	11,417,283	(C)
	-----	-----	
Employee stock options exercised	1,794,850	1,794,850	
Stock option expense	1,173,751	1,173,751	
Adjustment to initially apply FASB Statement No. 158,			



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net of tax	169,003	169,003
Increase in net assets	117,725,403	167,695,699
Net assets, beginning of year	396,618,109	558,035,990
Net assets, end of year	514,343,512	725,731,689
Net asset value, per share	\$ 132.36	\$ 186.75

Nine Months Ended December 31, 2006

Consolidated Statement of Changes in Net Assets	Previously Reported (1)	As Restated (2)
Net investment income	3,278,407	3,278,407
Net realized gain on investments	19,049,091	18,066,438 (B)
Net increase in unrealized appreciation of investments	81,044,543	124,061,543 (A)
Increase in net assets from operations	103,372,041	145,406,388
Distributions from undistributed net investment income	(2,323,150)	(2,323,150)
Capital share transactions		
Exercise of employee stock options	1,794,850	1,794,850
Adjustment to initially apply FASB No. 158, net of tax	--	--
Stock option expense	125,417	125,417
Increase in net assets	102,969,158	145,003,505
Net assets, beginning of year	396,618,109	558,035,990
Net assets, end of year	499,587,267	703,039,495
Net asset value, per share	\$ 128.56	\$ 180.91

Nine Months Ended December 31, 2006

Consolidated Statement of Cash Flow	Previously Reported (1)	As Restated (2)
Net cash provided by operating activities	45,554,770	45,554,770
Net cash used in financing activities	(528,300)	(528,300)
Net increase in cash and cash equivalents	45,026,470	45,026,470

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Notes to Consolidated Financial Statements  
(continued)

Three Months Ended December 31, 2006

Consolidated Statement of Cash Flow	Previously Reported (1)	As Restated (2)
Net cash provided by operating activities	33,114,591	33,114,591
Net cash used in financing activities	(853,750)	(853,750)
Net decrease in cash and cash equivalents	32,260,841	32,260,841

- 
- (1) As presented in the Company's original Form 10-Q for the quarter ended December 31, 2006.
  - (2) Adjusted to reflect the restatement described above.
  - (3) As presented in the Company's original Form 10-K for the fiscal year ended March 31, 2007.
- (A), (B) and (C) are described in detail above.

### 3. Income Taxes

For the tax years ended December 31, 2007 and 2006, Capital Southwest Corporation ("CSC") and Capital Southwest Venture Corporation ("CSVC") qualified to be taxed as RICs. We intend to meet the applicable qualifications to be taxed as a RIC in future years; management feels it is probable that we will maintain our RIC status for a period longer than one year. However, either company's ability to meet certain portfolio diversification requirements of RICs in future years may not be controllable by such company.

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 its wholly owned portfolio companies. Deferred taxes related to the qualified defined pension plan are recorded as incurred.

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### 4. 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 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, we adopted SFAS 123R using the modified prospective transition method. We recognize 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 quarter and nine months ended December 31, 2007, we recognized compensation expense of \$87,988 and \$175,676, respectively.

As of December 31, 2007, the total remaining unrecognized compensation cost related to non-vested stock options was \$1,883,824, which will be amortized over the weighted-average service period of approximately 6.2 years.

### 5. Employee Stock Option Plan

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

At December 31, 2007, 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 \$31.28 per option using the Black-Scholes pricing model with the following assumptions: expected dividend yield of .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 \$33.05 per option using the Black-Scholes pricing model with the following assumptions: expected dividend yield of .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 .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 plan since March 31, 2007:

	Number of shares	Weighted-Average Exercise Price
Balance at March 31, 2007	52,500	\$ 86.18

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Granted	25,000	152.98
Exercised	(3,100)	74.64
Canceled	(4,000)	93.49
	-----	-----
Balance at December 31, 2007	70,400	\$109.99
	=====	=====

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Notes to Consolidated Financial Statements  
(continued)

At December 31, 2007, the range of exercise prices and weighted-average remaining contractual life of outstanding options was \$65.00 to \$152.98 and 6.16 years, respectively. The total intrinsic value of options exercised during the nine months ended December 31, 2007 was \$75,129 with the exercise prices ranging from \$65.00 to \$93.49 per share. A total of 3,100 new shares were issued for the \$231,390 cash received from option exercises for the nine months ended December 31, 2007.

At December 31, 2007, the number of options exercisable was 9,930 and the weighted-average exercise price of those options was \$79.01.

6. Summary of Per Share Information

	Three Months Ended December 31		Nine Months Ended December 31	
	2007	2006 as restated	2007	2006 as restated
Investment income	\$ .67	\$ .59	\$ 1.41	\$ 1.37
Operating expenses	(.20)	(.13)	(.46)	(.40)
Interest expense	--	(.04)	--	(.12)
Income taxes	(.01)	--	(.01)	(.01)
	-----	-----	-----	-----
Net investment income	.46	.42	.94	.84
Distributions from undistributed net investment income	(.40)	(.40)	(.60)	(.60)
Net realized gains deemed distributed to shareholders	--	(2.94)	--	(2.94)
Net realized gain on investments	(.12)	2.17	.06	4.66
Net increase (decrease) in unrealized appreciation of investments	(16.66)	34.02	(47.77)	31.92
Allocated increase in share value for deemed distributions	--	2.94	--	2.94
Exercise of employee stock options *	--	(.20)	(.09)	(.50)
Stock option expense	.02	.01	.05	.03
	-----	-----	-----	-----
Increase (decrease) in net asset value	(16.70)	36.02	(47.41)	36.35
Net asset value:				
Beginning of period	156.04	144.89	186.75	144.56
	-----	-----	-----	-----
End of period	\$139.34	\$180.91	\$139.34	\$180.91

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	=====	=====	=====	=====
Shares outstanding at end of period (000s omitted)	3,889	3,886	3,889	3,886

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

### 7. Subsequent Events

On January 9, 2008, the Company filed its Form 10-Q for the quarter ended September 30, 2007 with the Securities and Exchange Commission and NASDAQ. Additionally, the Company filed its restated Form 10-K/A for the year ended March 31, 2007 and Form 10-Q/A for the quarter ended June 30, 2007 with the Securities and Exchange Commission as explained in Note 2 "Restatement."

On January 10, 2008, the Company received a "moot" letter from NASDAQ informing it that its filing delinquency had been cured. Accordingly, the Company is in compliance with Rule 4310(c) (14).

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### Notes to Consolidated Financial Statements (continued)

#### 8. Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, "Fair Value Measurements" (SFAS 157). The standard defines fair value, outlines a framework for measuring fair value, and details the required disclosures about fair value measurements. The standard is effective for years beginning after November 15, 2007; therefore, we will adopt SFAS 157 effective April 1, 2008. We are evaluating the impact of SFAS 157.

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. SFAS 159 is effective for us beginning April 1, 2008. We are evaluating the impact of SFAS 159. The impact, if any, from the adoption of SFAS 159 has not been determined.

Net asset value at December 31, 2007 was \$541,924,018, equivalent to \$139.34 per share. Assuming reinvestment of all dividends and tax credits on retained long-term capital gains, the December 31, 2007 net asset value reflects a decrease of 22.63% during the past twelve months.

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

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### Item 2. Managements Discussion and Analysis of Financial Condition and Results of Operations

#### Results of Operations

The composite measure of our financial performance in the Consolidated Statements of Operations is captioned "Increase (decrease) in net assets from operations" and consists of three elements. The first is "Net investment income", which is the difference between our income from interest, dividends and fees and our 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. The third element is the "Net increase (decrease) in unrealized appreciation of investments", which is the net change in the market or fair value of our investment portfolio, compared with stated cost. It should be noted that the "Net realized gain (loss) on investments" and "Net increase (decrease) 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 "unrealized" to "realized". Conversely, when a loss is realized on a depreciated portfolio security, an increase in net unrealized appreciation occurs.

#### Net Investment Income

Interest income of \$1,797,079 for the nine months ended December 31, 2007 increased from \$1,624,418 for nine months ended December 31, 2006, due to an increase in excess cash and interest rates. During the nine months ended December 31, 2007 and 2006, we recorded dividend income from the following sources:

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

	Nine Months Ended December 31	
	2007	2006
	----	----
Alamo Group Inc.	\$ 508,914	\$ 507,834
Balco, Inc.	224,400	--
Dennis Tool Company	49,999	62,499
Encore Wire Corporation	245,205	--
Kimberly-Clark Corporation	122,716	113,455
Lifemark Group	571,333	450,000
PalletOne, Inc.	--	89,842
PETsMart, Inc.	27,000	27,000
The RectorSeal Corporation	914,133	1,629,947
TCI Holdings, Inc.	60,953	60,953
The Whitmore Manufacturing Company	228,533	180,000
Other	50,465	45,673
	\$ 3,003,651	\$ 3,167,203
	=====	=====

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### Net Increase (Decrease) in Unrealized Appreciation of Investments

Set forth in the following table are the significant increases and decreases in unrealized appreciation by portfolio company:

	Three Months Ended December 31 -----		Nine Months Ended December 31 -----	
	2007 ----	2006 ----	2007 ----	2006 ----
Alamo Group, Inc.	\$ (9,905,950)	\$ --	\$ (9,878,840)	\$ --
Encore Wire Corporation	(30,650,750)	(28,608,000)	(24,520,750)	(20,434,000)
Heelys, Inc.	(18,634,760)	135,681,510	(158,394,760)	165,681,510
Palm Harbor Homes, Inc.	(11,782,713)	(3,928,000)	(19,637,713)	(27,493,000)
The RectorSeal Corporation	11,150,000	10,500,000	22,000,000	10,500,000

During the nine months ended December 31, 2007, the value of our investment in The RectorSeal Corporation was increased by \$22,000,000 due to increased sales and earnings at the company derived largely from growing demand for the smoke containment systems manufactured by its Smoke Guard subsidiary.

Offsetting the gain at RectorSeal during the nine months ended December 31, 2007, was a \$158,394,760 decline in the value of Heelys, Inc., which experienced significantly slower growth and an extreme decline in market price during the past quarter; a \$24,520,750 decline in the value of Encore Wire Corporation due to reduced demand attributable to the residential slowdown and declining margins needed to be competitive; a \$19,637,713 decline in the value of Palm Harbor Homes, Inc. due to the deterioration of the manufactured housing market; and a \$9,878,840 decline in the value of Alamo Group, Inc. due to inventory shortages that are back logged and excessive startup expenses for the manufacturing of its sweeper line.

#### Portfolio Investments

During the quarter ended December 31, 2007, we made additional investments of \$817,186 in an existing portfolio company.

We have agreed, subject to certain conditions, to invest up to \$6,029,760 in three portfolio companies.

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

#### Financial Liquidity and Capital Resources

At December 31, 2007, we had cash and cash equivalents of approximately \$31.9 million. Pursuant to Small Business Administration (SBA) regulations, cash and cash equivalents of \$4.6 million held by Capital Southwest Venture Corporation (CSVC) may not be transferred or advanced to us without the consent of the SBA. Under current SBA regulations and subject to 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

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of the stock of a portfolio company in the fiscal year ended March 31, 1996, we have 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 our investment activity. Approximately \$61.0 million of our investment portfolio is represented by unrestricted publicly-traded securities, and represent a source of liquidity.

Funds to be used by us 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, to the extent of their available cash reserves and borrowing capacities.

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

### Item 3. Quantitative and Qualitative Disclosure About Market Risk

We are subject to financial market risks, including changes in marketable equity security prices. We do not use derivative financial instruments to mitigate any of these risks.

Our investment performance is a function of our portfolio companies' profitability, which may be affected by economic cycles, competitive forces, foreign currency fluctuations and production costs including labor rates, raw material prices and certain commodity prices. Most of the companies in our investment portfolio do not hedge their exposure to raw material and commodity price fluctuations. However, the portfolio company with the greatest exposure to foreign currency fluctuations generally hedges its exposure. All of these factors may have an adverse effect on the value of our investments on our net asset value.

Our investment in portfolio securities includes fixed-rate debt securities which totaled \$9,000,000 at December 31, 2007, equivalent to 1.8% of the value of our total investments. Generally these debt securities are below investment grade and have relatively high fixed rates of interest; therefore, minor changes in market yields of publicly-traded debt securities have little or no effect on the values of debt securities in our portfolio and no effect on interest income. Our investments in debt securities are generally held to maturity and their fair values are determined on the basis of the terms of the debt security and the financial condition of the issuer.

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### Item 3. Quantitative and Qualitative Disclosure About Market Risk (continued)

A portion of our investment portfolio consists of debt and equity securities of private companies. We anticipate little or no effect on the values of these investments from modest changes in public market equity valuations. Should significant changes in market valuations of comparable publicly-owned companies occur, there may be a corresponding effect on valuations of private companies, which would affect the value and the amount and timing of proceeds eventually realized from these investments. A portion of our investment portfolio also consists of restricted common stocks of publicly-owned companies. The fair values of these restricted securities are influenced by the nature of applicable resale restrictions, the underlying earnings and financial condition



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of the issuers of such restricted securities and the market valuations of comparable publicly-owned companies. A portion of our investment portfolio also consists of unrestricted, freely marketable common stocks of publicly-owned companies. These freely marketable investments, which are valued at the public market price, are directly exposed to equity price risks, in that a change in an issuer's public market equity price would result in an identical change in the fair value of our investment in such security.

### Item 4. Controls and Procedures

An evaluation was performed under the supervision and with the participation of our Management, including the President and Controller, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934). Based on that evaluation, the President and Controller concluded that our disclosure controls and procedures were not effective due to a material weakness in the Company's internal control over financial reporting ("ICFR") disclosed in "Item 9A. Controls and Procedures" of the Company's Annual Report on Form 10-K/A, for the fiscal year ended March 31, 2007. The following material weakness is the basis for our conclusion:

- o We did not maintain an adequate process to assess and determine the probability of the Company maintaining its qualifying status as a RIC subject to subchapter M of the IRC over the next twelve months at any given quarter.

To address this material weakness, Management will add a formal evaluation to consider whether it is probable the company will not qualify as a RIC subject to Subchapter M of the IRC over the next 12 months at any given quarter. Additionally, the Company will review its investment gains quarterly and calculate the tax impact on those gains it will retain, however, they will only record the tax liability at the last day of the tax year. Management will also determine, based on materiality, any footnote disclosure that may be required during the interim periods. Furthermore, Management will review and assess temporary and permanent differences for reclassification to "additional capital" at each tax year end. When considered necessary by Management, an independent attorney or accountant with requisite knowledge of investment company taxation will be consulted in order to provide necessary guidance. Accordingly, Management believes that the financial statements included in this report fairly represent in all material respects the Company's financial position, results of operations and cash flows for the periods presented. There were no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect our ICFR during the fiscal quarter ended December 31, 2007.

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## PART II. OTHER INFORMATION

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### Item 1. Legal Proceedings

We are currently the subject of certain legal actions. In our judgment, none of the lawsuits currently pending against us, either individually or in the aggregate, is likely to have a material adverse effect on our business, results of operations, or financial position.

We, Capital Southwest Corporation and Capital Southwest Venture Corporation, have been named in a lawsuit filed on August 27, 2007 in the United

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States District Court of the Northern District of Texas, Dallas Division, against Heelys, Inc and its Chief Executive Officer, Chief Financial Officer and the directors who signed its registration statement with the Securities and Exchange Commission in connection with its December 7, 2006 initial public offering ("IPO"), and its underwriters for the IPO. The complaint alleges violations of Sections 11 and 15 of the Securities Act of 1933 and the plaintiffs are seeking compensatory damages in an unspecified amount, as well as reasonable costs and expenses incurred in the action, including counsel fees and expert fees.

Four similar suits were also filed in September and October 2007 in the United States District Court of the Northern District of Texas making substantially similar allegations under Sections 11, 12 and 15 of the Securities Act of 1933, and seeking substantially similar damages. These lawsuits have been transferred to a single judge, and we expect that all the cases will be consolidated into a single action, with a consolidated complaint filed shortly thereafter.

We believe that the plaintiffs' claims are without merit, we deny the allegations in the complaints, and we intend to vigorously defend the lawsuits.

### Item 1A. Risk Factors

There have been no material changes to our risk factors as disclosed in Item 1A, "Risk Factors", in our Annual Report on Form 10-K/A for the fiscal year ended March 31, 2007.

### Item 6. Exhibits and Reports on Form 8-K

#### (a) Exhibits

Exhibit 31.1- Certification of President required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), filed herewith.

Exhibit 31.2- Certification of Controller required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act, filed herewith.

Exhibit 32.1- Certification of President required by Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code, furnished herewith.

Exhibit 32.2- Certification of Controller required by Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code, furnished herewith.

#### (b) Reports on Form 8-K

No reports on Form 8-K have been filed during the quarter for which this report is filed.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CAPITAL SOUTHWEST CORPORATION

Date: February 8, 2008  
-----

By: /s/ Gary L. Martin  
-----  
Gary L. Martin, President  
(chief executive officer)

Date: February 8, 2008  
-----

By: /s/ Tracy L. Morris  
-----  
Tracy L. Morris, Controller  
(chief financial/accounting)