

CAPITAL SOUTHWEST CORP
Form 10-Q
August 06, 2012

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 June 30, 2012

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 75230
(Address of principal executive offices) (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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such filings). Yes 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," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

Exchange Act. (Check One):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

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

3,798,078 shares of Common Stock, \$1 par value, as of July 31, 2012

TABLE OF CONTENTS

PART I	FINANCIAL INFORMATION	Page
Item 1.	Consolidated Financial Statements	
	<u>Consolidated Statements of Assets and Liabilities June 30, 2012 (Unaudited) and March 31, 2012</u>	3
	<u>Consolidated Statements of Operations (Unaudited) For the three months ended June 30, 2012 and June 30, 2011</u>	4
	<u>Consolidated Statements of Changes in Net Assets June 30, 2012 (Unaudited) and June 30, 2011 (Unaudited)</u>	5
	<u>Consolidated Statements of Cash Flows (Unaudited) For the three months ended June 30, 2012 and June 30, 2011</u>	6
	<u>Consolidated Schedule of Investments June 30, 2012 (Unaudited) and March 31, 2012</u>	7
	<u>Notes to Consolidated Financial Statements</u>	19
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	32
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	35
Item 4.	<u>Controls and Procedures</u>	36
PART II	OTHER INFORMATION	
Item 1.	<u>Legal Proceedings</u>	36
Item 1A.	<u>Risk Factors</u>	36
Item 6.	<u>Exhibits</u>	36
	<u>Signatures</u>	37

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

(In thousands except per share data)

	June 30 2012	March 31 2012
Assets		
Investments at market or fair value		
Companies more than 25% owned (Cost: June 30, 2012 - \$12,678, March 31, 2012 - \$14,870)	\$286,825	\$283,575
Companies 5% to 25% owned (Cost: June 30, 2012 - \$15,594, March 31, 2012 - \$14,003)	126,743	209,222
Companies less than 5% owned (Cost: June 30, 2012 - \$66,354, March 31, 2012 - \$60,120)	72,090	65,749
Total investments (Cost: June 30, 2012 - \$94,626, March 31, 2012 - \$88,993)	485,658	558,546
Cash and cash equivalents	65,735	64,895
Receivables		
Dividends and interest	2,176	1,741
Affiliates	–	220
Other	921	–
Pension assets	7,445	7,349
Other assets	203	238
Total assets	\$562,138	\$632,989
Liabilities		
Other liabilities	\$512	\$688
Investment commitment payable	5,950	–
Accrued pension cost	1,589	1,568
Deferred income taxes	2,053	2,027
Total liabilities	10,104	4,283
Net Assets		
Common stock, \$1 par value: authorized, 5,000,000 shares; issued, 4,382,956 shares at June 30, 2012 and 4,339,416 March 31, 2012	4,383	4,339
Additional capital	181,070	177,841
Accumulated net investment income/ (loss)	(1,075)	412
Accumulated net realized gain	561	498
Unrealized appreciation of investments	391,032	469,553
Treasury stock - at cost on 584,878 shares	(23,937)	(23,937)
Total net assets	552,034	628,706
Total liabilities and net assets	\$562,138	\$632,989
Net asset value per share (on the 3,798,078 shares outstanding at June 30, 2012 and 3,754,538 March 31, 2012)	\$145.73	\$167.45

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)
(In thousands)

	Three Months Ended June 30	
	2012	2011
Investment income:		
Interest	\$587	\$453
Dividends	572	572
Management fees and other income	292	171
	1,451	1,196
Operating expenses:		
Salaries	617	472
Stock option expense	257	245
Net pension benefit	(75)	(73)
Professional fees	307	305
Other operating expenses	313	216
	1,419	1,165
Income before income taxes	32	31
Income tax expense	14	17
Net investment income	\$18	\$14
Proceeds from disposition of investments	67,505	39
Cost of investments sold	617	5,950
Net realized gain (loss) on investments	66,888	(5,911)
Net decrease in unrealized appreciation of investments	(78,521)	(4,558)
Net realized and unrealized loss on investments	\$(11,633)	\$(10,469)
Decrease in net assets from operations	\$(11,615)	\$(10,455)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(Unaudited)
(In thousands)

	Three Months Ended June 30	
	2012	2011
Operations:		
Net investment income	\$18	\$14
Net realized gain (loss) on investments	66,888	(5,911)
Net decrease in unrealized appreciation of investments	(78,521)	(4,558)
Decrease in net assets from operations	(11,615)	(10,455)
Distributions from:		
Undistributed net investment income	(1,505)	(1,501)
Undistributed net realized gain	(66,826)	-
Capital share transactions:		
Exercise of employee stock options	3,017	-
Stock option expense	257	245
Decrease in net assets	(76,672)	(11,711)
Net assets, beginning of period	628,706	539,233
Net assets, end of period	\$552,034	\$527,522

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(In thousands)

	Three Months Ended June 30	
	2012	2011
Cash flows from operating activities		
Decrease in net assets from operations	\$(11,615)	\$(10,455)
Adjustments to reconcile decrease in net assets from operations to net cash provided by (used in) operating activities:		
Net proceeds from disposition of investments	67,505	39
Proceeds from repayment of loans	-	111
Purchases of securities	(6,251)	(9,822)
Depreciation and amortization	11	5
Net pension benefit	(75)	(73)
Realized (gain) loss on investments before income tax	(66,888)	5,911
Net decrease in unrealized appreciation of investments	78,521	4,558
Stock option expense	257	245
Increase in dividend and interest receivable	(435)	(229)
(Increase) /Decrease in receivables from affiliates and other receivables	(701)	340
Increase in other assets	25	1
(Decrease)/Increase in other liabilities	(176)	22
Increase in commitment payable	5,950	-
Increase in deferred income taxes	26	25
Net cash provided by (used in) operating activities	66,154	(9,322)
Cash flows from financing activities		
Distributions from undistributed net investment income	(1,505)	(1,501)
Proceeds from exercise of employee stock options	3,017	-
Dividends paid from net realized gain	(66,826)	-
Purchase of treasury stock	-	-
Net cash used in financing activities	(65,314)	(1,501)
Net increase (decrease) in cash and cash equivalents	840	(10,823)
Cash and cash equivalents at beginning of period	64,895	45,498
Cash and cash equivalents at end of period	\$65,735	\$34,675
Supplemental disclosure of cash flow information:		
Income taxes	\$-	\$-

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

June 30, 2012

Company	Equity (a)		Investment (b)	Cost	Value (c)
*†ALAMO GROUP INC. Seguin, Texas Tractor-mounted mowing and mobile excavation equipment for governmental, industrial and agricultural markets; street-sweeping equipment for municipalities.	22.0	%	‡2,832,300 shares common stock (acquired 4-1-73 thru 5-09-11)	\$ 2,190,937	\$ 88,802,196
ATLANTIC CAPITAL BANCSHARES, INC Atlanta, Georgia 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	2,299,000
¥BALCO, INC. Wichita, Kansas Specialty architectural products used in the construction and remodeling of commercial and institutional buildings.	95.7	%	445,000 shares common stock and 60,920 shares Class B non-voting common stock (acquired 10-25-83 and 5-30-02)	624,920	4,100,000
*BOXX TECHNOLOGIES, INC. Austin, Texas Workstations for computer graphic imaging and design.	14.9	%	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	780,000
CINATRA CLEAN TECHNOLOGIES, INC. Houston, Texas Cleans above ground oil storage tanks with a patented, automated system.	73.4	%	12% subordinated secured promissory note, due 5-9-2016 (acquired 5-19-10 thru 10-20-10)	779,278	494,000
			12% subordinated secured promissory note, due 5-9-2017 (acquired 5-9-11 thru 10-26-11)	2,285,700	1,448,000
			12% subordinated secured promissory note, due 8-31-2016 (acquired 9-9-11 and 10-26-11)	1,523,800	965,000
			10% subordinated secured promissory note, due 5-9-2017 (acquired 7-14-08 thru 4-28-10)	6,200,700	3,928,000
				3,033,410	1

			3,033,410 shares Series A Convertible Preferred Stock, convertible into 3,033,410 shares common stock at \$1.00 per share (acquired 7-14-08 thru 11-18-10)		
			Warrants to purchase 1,269,833 shares of common stock at \$1.00 per share, expiring 8-31-2021 (acquired 5-9-11 thru 8-31-11)	-	-
				13,822,888	6,835,001
*†ENCORE WIRE CORPORATION McKinney, Texas Electric wire and cable for residential, commercial and industrial construction use.	6.2	%	‡1,312,500 shares common stock (acquired 9-10-92 thru 10-15-98)	5,200,000	35,135,625

†Publicly-owned company ¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note (a)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

June 30, 2012

Company	Equity (a)		Investment (b)	Cost	Value (c)
EXTREME INTERNATIONAL, INC. Sugar Land, Texas Owns Bill Young Productions, Texas Video and Post, and Extreme and television commercials and corporate communications videos.	53.6	%	13,035 shares Series A Common Stock (acquired 9-26-08 and 12-18-08)	325,875	734,000
			39,359.18 shares Series C Convertible Preferred Stock, convertible into 157,437.72 shares of common stock at \$25.00 per share (acquired 9-30-03)	2,625,000	8,869,000
			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)	375,000	845,000
				3,325,875	10,448,000
†HEELYS, INC. Carrollton, Texas 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
†HOLOGIC, INC. Bedford, Massachusetts Medical instruments including bone densitometers, mammography devices and digital radiography systems.	< 1	%	582,820 shares common stock (acquired 8-27-99)	202,529	10,514,073
iMEMORIES, INC. Scottsdale, Arizona Enables online video and photo sharing and DVD creation for home movies recorded in analog and new digital format.	23	%	17,391,304 shares Series B Convertible Preferred Stock, convertible into 19,891,304 shares of common stock at \$0.23 per share (acquired 7-10-09)	4,000,000	4,000,000
			4,684,967 shares Series C Convertible Preferred Stock, convertible into 4,684,967 shares of common stock at \$0.23 per share (acquired 7-20-11)	1,078,479	1,078,479
			Warrants to purchase 2,500,000 shares of common	–	–

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

stock at \$0.12 per share,
 expiring 1-21-21 (acquired
 9-13-10 thru 1-21-11)

				5,078,479	5,078,479
INSTAWARES HOLDING COMPANY, LLC Atlanta, Georgia Provides services to the restaurant industry via its five subsidiary companies.	4.5	%	3,846,154 Class D shares (acquired 5-20-11)	5,000,000	5,574,000

†Publicly-owned company ¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note
 (a)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

June 30, 2012

Company	Equity (a)		Investment (b)	Cost	Value (c)
KBI BIOPHARMA, INC. Durham, North Carolina Provides fully-integrated, outsourced drug development and bio-manufacturing services.	17.1	%	7,142,857 shares Series B-2 Convertible Preferred Stock, convertible into 7,142,857 shares of common stock at \$0.49 per share (acquired 9-08-09)	5,000,000	4,700,000
			Warrants to purchase 67,789 shares of preferred stock at \$ 0.70 per share, expiring 1-26-2012	-	-
				5,000,000	4,700,000
¥MEDIA RECOVERY, INC. Dallas, Texas Computer datacenter and office automation supplies and accessories; impact, tilt monitoring and temperature sensing devices to detect mishandling shipments; dunnage for protecting shipments.	97.9	%	800,000 shares Series A Convertible Preferred Stock, convertible into 800,000 shares of common stock at \$1.00 per share (acquired 11-4-97)	800,000	2,600,000
			4,000,002 shares common stock (acquired 11-4-97)	4,615,000	12,800,000
				5,415,000	15,400,000
*PALLETONE, INC. Bartow, Florida Manufacturer of wooden pallets and pressure-treated lumber.	7.7	%	12.3% senior subordinated notes, \$2,000,000 principal due 12-18-2015 (acquired 9-25-06)	1,553,150	2,000,000
			150,000 shares common stock (acquired 10-18-01)	150,000	2
				1,703,150	2,000,002
¥THE RECTORSEAL CORPORATION Houston, Texas Specialty chemicals for plumbing, HVAC, electrical, construction, industrial, oil field and automotive applications; smoke containment systems for building fires; also owns 20% of The Whitmore Manufacturing Company.	100.0	%	27,907 shares common stock (acquired 1-5-73 and 3-31-73)	52,600	173,800,000
TCI HOLDINGS, INC. Denver, Colorado Cable television systems and microwave relay systems.	-		21 shares 12% Series C Cumulative Compounding Preferred Stock (acquired 1-30-90)	-	792,000

†Publicly-owned company ¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note
(a)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

June 30, 2012

Company	Equity (a)		Investment (b)	Cost	Value (c)
TITANLINER, INC. Midland, Texas Manufactures, installs and rents spill containment system for oilfield applications.	29.9	%	217,038 shares Series A Convertible Preferred Stock convertible into 217,038 shares of Series A preferred stock at \$12.65 per share (acquired 6-29-2012)	3,203,000	3,203,000
			7% senior subordinated secured promissory note, due 6-30-2017 (acquired 6-29-2012)	2,747,000	2,747,000
			Warrants to purchase 122,239 shares of Series A preferred stock at \$ 0.01 per share, expiring 1-26-2012	-	-
				5,950,000	5,950,000
TRAX HOLDINGS, INC. Scottsdale, Arizona Provides a comprehensive set of solutions to improve the transportation validation, accounting, payment and information management process.	25.4	%	18% convertible promissory note, \$3,200,000 principal due 9-17-2012 (acquired 4-6-11 thru 11-10-11)	3,200,000	3,200,000
			1,061,279 shares Series A Convertible Preferred Stock, convertible into 1,061,279 common stock at \$4.64 per share (acquired 12-8-08 and 2-17-09)	5,000,000	6,800,000
				8,200,000	10,000,000
VIA HOLDINGS, INC. Sparks, Nevada Designer, manufacturer and distributor of high-quality office seating.	3.2	%	12,686 shares common stock (acquired 3-4-11 and 3-25-11)	4,926,290	2
*WELLOGIX, INC. Houston, Texas Developer and supporter of software used by the oil and gas industry.	19.1	%	4,788,371 shares Series A-1 Convertible Participating Preferred Stock, convertible into 4,788,371 shares of common stock at \$1.0441 per share (acquired 8-19-05 thru 6-15-08)	5,000,000	25,000

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

†THE WHITMORE MANUFACTURING COMPANY Rockwall, Texas 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	68,200,000
MISCELLANEOUS	–		Ballast Point Ventures II, L.P. 2.2% limited partnership interest (acquired 8-4-08 thru 6-18-10)	1,725,000	1,534,000

†Publicly-owned company ‡Control investment * Affiliated investment ‡Unrestricted securities as defined in Note
(a)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

June 30, 2012

Company	Equity (a)	Investment (b)	Cost	Value (c)
Miscellaneous (continued)	–	BankCap Partners Fund I, L.P. 5.5% limited partnership interest (acquired 7-14-06 thru 11-30-11)	5,850,470	5,012,000
	–	CapitalSouth Partners Fund III, L.P. 1.9% limited partnership interest (acquired 1-22-08 and 11-16-11)	1,331,256	1,548,000
	100.0 %	¥CapStar Holdings Corporation 500 shares common stock (acquired 6-10-10)	3,703,619	5,632,000
	–	Diamond State Ventures, L.P. 1.4% limited partnership interest (acquired 10-12-99 thru 8-26-05)	76,000	201,000
	–	¥Discovery Alliance, LLC 90.0% limited liability company (acquired 9-12-08 thru 10-20-11)	1,180,000	1,735,000
	–	First Capital Group of Texas III, L.P. 3.0% limited partnership interest (acquired 12-26-00 thru 8-12-05)	778,895	771,000
	100 %	¥Humac Company 1,041,000 shares common stock (acquired 1-31-75 and 12-31-75)	–	162,000
	–	STARTech Seed Fund I 12.1% limited partnership interest (acquired 4-17-98 thru 1-5-00)	178,066	34,000
	–	STARTech Seed Fund II 3.2% limited partnership interest (acquired 4-28-00 thru 2-23-05)	843,891	384,000
	–	Sterling Group Partners I, L.P. 1.7% limited partnership interest (acquired 4-20-01 thru 1-24-05)	1,064,042	416,000
TOTAL INVESTMENTS			\$94,626,397	\$485,658,440

†Publicly-owned company ¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note
(a)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2012

Company	Equity (a)		Investment (b)	Cost	Value (c)
*†ALAMO GROUP INC. Seguin, Texas Tractor-mounted mowing and mobile excavation equipment for governmental, industrial and agricultural markets; street-sweeping equipment for municipalities.	22.0	%	‡2,832,300 shares common stock (acquired 4-1-73 thru 5-09-11)	\$ 2,190,937	\$ 85,138,938
ATLANTIC CAPITAL BANCSHARES, INC Atlanta, Georgia 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	2,299,000
¥BALCO, INC. Wichita, Kansas Specialty architectural products used in the construction and remodeling of commercial and institutional buildings.	95.7	%	445,000 shares common stock and 60,920 shares Class B non-voting common stock (acquired 10-25-83 and 5-30-02)	624,920	4,100,000
*BOXX TECHNOLOGIES, INC. Austin, Texas Workstations for computer graphic imaging and design.	14.9	%	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	600,000
CINATRA CLEAN TECHNOLOGIES, INC. Houston, Texas Cleans above ground oil storage tanks with a patented, automated system.	73.4	%	12% subordinated secured promissory note, due 5-9-2016 (acquired 5-19-10 thru 10-20-10)	779,278	444,189
			12% subordinated secured promissory note, due 5-9-2017 (acquired 5-9-11 thru 10-26-11)	2,285,700	1,302,849
			12% subordinated secured promissory note, due 8-31-2016 (acquired 9-9-11 and 10-26-11)	1,264,754	720,910
			10% subordinated secured promissory note, due 5-9-2017 (acquired 7-14-08 thru 4-28-10)	6,200,700	3,534,399

			3,033,410 shares Series A Convertible Preferred Stock, convertible into 3,033,410 shares common stock at \$1.00 per share (acquired 7-14-08 thru 11-18-10)	3,033,410	1
			Warrants to purchase 1,269,833 shares of common stock at \$1.00 per share, expiring 8-31-2021 (acquired 5-9-11 thru 8-31-11)	–	–
				13,563,842	6,002,348
*†ENCORE WIRE CORPORATION McKinney, Texas Electric wire and cable for residential, commercial and industrial construction use.	16.9	%	‡4,086,750 shares common stock (acquired 7-16-92 thru 10-7-98)	5,800,000	121,458,210

†Publicly-owned company ¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note (a)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2012

Company	Equity (a)		Investment (b)	Cost	Value (c)
EXTREME INTERNATIONAL, INC. Sugar Land, Texas Owns Bill Young Productions, Texas Video and Post, and Extreme and television commercials and corporate communications videos.	53.6	%	13,035 shares Series A Common Stock (acquired 9-26-08 and 12-18-08)	325,875	714,000
			39,359.18 shares Series C Convertible Preferred Stock, convertible into 157,437.72 shares of common stock at \$25.00 per share (acquired 9-30-03)	2,625,000	8,626,000
			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)	375,000	822,000
				3,325,875	10,162,000
†HEELYS, INC. Carrollton, Texas 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	20,498,082
†HOLOGIC, INC. Bedford, Massachusetts Medical instruments including bone densitometers, mammography devices and digital radiography systems.	< 1	%	†632,820 shares common stock (acquired 8-27-99)	220,000	13,637,271
iMEMORIES, INC. Scottsdale, Arizona Enables online video and photo sharing and DVD creation for home movies recorded in analog and new digital format.	25.3	%	17,391,304 shares Series B Convertible Preferred Stock, convertible into 19,891,304 shares of common stock at \$0.23 per share (acquired 7-10-09)	4,000,000	4,000,000
			4,684,967 shares Series C Convertible Preferred Stock, convertible into 4,684,967 shares of common stock at \$0.23 per share (acquired 7-20-11)	1,078,479	1,078,479
			Warrants to purchase 2,500,000 shares of common stock at \$0.12 per share,	–	–

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

			expiring 1-21-21 (acquired 9-13-10 thru 1-21-11)	5,078,479	5,078,479
INSTAWARES HOLDING COMPANY, LLC Atlanta, Georgia Provides services to the restaurant industry via its five subsidiary companies.	4.5	%	3,846,154 Class D shares (acquired 5-20-11)	5,000,000	5,000,000
KBI BIOPHARMA, INC. Durham, North Carolina Provides fully-integrated, outsourced drug development and bio-manufacturing services.	17.1	%	7,142,857 shares Series B-2 Convertible Preferred Stock, convertible into 10,204,082 shares of common stock at \$0.49 per share (acquired 9-08-09)	5,000,000	3,200,000

†Publicly-owned company ¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note (a)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2012

Company	Equity (a)		Investment (b)	Cost	Value (c)
¥MEDIA RECOVERY, INC. Dallas, Texas Computer datacenter and office automation supplies and accessories; impact, tilt monitoring and temperature sensing devices to detect mishandling shipments; dunnage for protecting shipments.	97.9	%	800,000 shares Series A Convertible Preferred Stock, convertible into 800,000 shares of common stock at \$1.00 per share (acquired 11-4-97)	800,000	3,100,000
			4,000,002 shares common stock (acquired 11-4-97)	4,615,000	15,600,000
				5,415,000	18,700,000
*PALLETONE, INC. Bartow, Florida Manufacturer of wooden pallets and pressure-treated lumber.	7.7	%	12.3% senior subordinated notes, \$2,000,000 principal due 12-18-2015 (acquired 9-25-06)	1,553,150	2,000,000
			150,000 shares common stock (acquired 10-18-01)	150,000	2
				1,703,150	2,000,002
¥THE RECTORSEAL CORPORATION Houston, Texas Specialty chemicals for plumbing, HVAC, electrical, construction, industrial, oil field and automotive applications; smoke containment systems for building fires; also owns 20% of The Whitmore Manufacturing Company.	100.0	%	27,907 shares common stock (acquired 1-5-73 and 3-31-73)	52,600	166,300,000
TCI HOLDINGS, INC. Denver, Colorado Cable television systems and microwave relay systems.	—		21 shares 12% Series C Cumulative Compounding Preferred Stock (acquired 1-30-90)	—	802,000
TRAX HOLDINGS, INC. Scottsdale, Arizona Provides a comprehensive set of solutions to improve the transportation validation, accounting, payment and information management process.	29.4	%	18% convertible promissory note, \$3,200,000 principal due 9-17-2012 (acquired 4-6-11 thru 11-10-11)	3,200,000	3,200,000
			1,061,279 shares Series A Convertible Preferred Stock, convertible into 1,061,279 common stock at \$4.64 per share (acquired 12-8-08 and 2-17-09)	5,000,000	6,600,000

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

				8,200,000	9,800,000
VIA HOLDINGS, INC. Sparks, Nevada Designer, manufacturer and distributor of high-quality office seating.	3.2	%	12,686 shares common stock (acquired 3-4-11 and 3-25-11)	4,926,290	2
*WELLOGIX, INC. Houston, Texas Developer and supporter of software used by the oil and gas industry.	19.1	%	4,788,371 shares Series A-1 Convertible Participating Preferred Stock, convertible into 4,788,371 shares of common stock at \$1.0441 per share (acquired 8-19-05 thru 6-15-08)	5,000,000	25,000

†Publicly-owned company ¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note (a)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2012

Company	Equity (a)	Investment (b)	Cost	Value (c)
¥THE WHITMORE MANUFACTURING COMPANY Rockwall, Texas 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	67,200,000
MISCELLANEOUS	–	Ballast Point Ventures II, L.P. 2.2% limited partnership interest (acquired 8-4-08 thru 6-18-10)	1,725,000	1,551,000
	–	BankCap Partners Fund I, L.P. 5.5% limited partnership interest (acquired 7-14-06 thru 11-30-11)	5,808,470	5,012,000
	–	CapitalSouth Partners Fund III, L.P. 1.9% limited partnership interest (acquired 1-22-08 and 11-16-11)	1,331,256	1,438,000
	100.0 %	¥CapStar Holdings Corporation 500 shares common stock (acquired 6-10-10)	3,703,619	5,338,000
	–	Diamond State Ventures, L.P. 1.4% limited partnership interest (acquired 10-12-99 thru 8-26-05)	76,000	184,000
	–	¥Discovery Alliance, LLC 90.0% limited liability company (acquired 9-12-08 thru 10-20-11)	1,180,000	1,280,000
	–	First Capital Group of Texas III, L.P. 3.0% limited partnership interest (acquired 12-26-00 thru 8-12-05)	778,895	662,000
	100 %	¥Humac Company 1,041,000 shares common stock (acquired 1-31-75 and 12-31-75)	–	159,000
	–	STARTech Seed Fund I	178,066	39,000

	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)	843,891	371,000

†Publicly-owned company ¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note (a)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2012

Company	Equity (a)	Investment (b)	Cost	Value (c)
Miscellaneous (continued)	–	Sterling Group Partners I, L.P. 1.7% limited partnership interest (acquired 4-20-01 thru 1-24-05)	1,064,042	511,000
TOTAL INVESTMENTS			\$88,992,822	\$558,546,332

†Publicly-owned company ¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note (a)

The accompanying Notes are an integral part of these Consolidated Financial Statements

Table of Contents

Notes to Consolidated Schedule of Investments

(a) Equity

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.

(b) Investments

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 June 30, 2012 and March 31, 2012, restricted securities represented approximately 68.7% and 56.9% of the value of the consolidated investment portfolio, respectively.

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 other privately held securities are valued as determined in good faith by our Board of Directors.

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 Topic 820, it is assumed that the reporting entity has access to the market as of the measurement date.

(c) Value

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 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, 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. For those without a principal market, our 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; and the proportion of the issuer’s securities owned by the Company. Investments in certain entities that calculate net asset value per share (or its equivalent) and for which fair market value is not readily determinable are valued using the net asset value per share (or its equivalent, such as member units or ownership interest in partners’ capital to which a proportionate share of net assets is attributed) of the investment.

Table of Contents

Equity Warrants are valued on the basis of the Black-Scholes model which defines the market value of a warrant in relation to the market price of its common stock, share price volatility, and time to maturity.

(d) Agreements between Certain Issuers and the Company

Agreements between certain issuers and the Company provide that the issuer will bear substantially all costs in connection with the Company disposing of such common stock, including those costs involved in registration under the Securities Act of 1933, but excluding underwriting discounts and commissions. These agreements cover common stock owned at June 30, 2012 and common stock which may be acquired thereafter through the exercise of warrants and conversion of debentures and preferred stock. They apply to restricted securities of all issuers in the investment portfolio of the Company except securities of the following issuers which are not obligated to bear registration costs: Humac Company and The Whitmore Manufacturing Company.

(e) Descriptions and Ownership Percentages

The descriptions of the companies and ownership percentages shown in the Consolidated Schedule of Investments were obtained from published reports and other sources believed to be reliable. Acquisition dates indicated are the dates specific securities were acquired, which may differ from the original investment dates. Certain securities were received in exchange for or upon conversion or exercise of other securities previously acquired.

Table of Contents

Notes to Consolidated Financial Statements

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

Capital Southwest Corporation ("CSC") was organized as a Texas corporation on April 19, 1961. Until September 1969, CSC operated as a licensee under the Small Business Investment Act of 1958. At that time, we transferred to our wholly-owned subsidiary, Capital Southwest Venture Corporation ("CSVC"), certain assets and our license as a small business investment company ("SBIC"). CSVC is a closed-end, non-diversified investment company registered under the Investment Company Act of 1940 (the "1940 Act"). Prior to March 30, 1988, CSC was registered as a closed-end, non-diversified investment company under the 1940 Act. On that date, CSC elected to become a Business Development Company ("BDC") subject to the provisions of the 1940 Act, as amended by the Small Business Incentive Act of 1980. Because CSC wholly owns CSVC, the portfolios of both CSC and CSVC are referred to collectively as "our," "we" and "us." Capital Southwest Management Company ("CSMC"), a wholly-owned subsidiary of CSC, is the management company for CSC and CSVC. CSMC generally incurs all normal operating and administrative expenses, including, but not limited to, salaries and related benefits, rent, equipment and other administrative costs required for its day-to-day operations.

Our portfolio is a composite of companies, consisting of companies in which we have controlling interests, developing companies and marketable securities of established publicly traded companies. We make available significant managerial assistance to the companies in which we invest and believe that providing managerial assistance to such investee companies is critical to their business development activities. CSMC receives a monthly fixed fee for management services provided to certain of its control portfolio companies.

Basis of Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). 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. Accordingly, consolidated financial statements include CSMC, our management company.

The financial statements included herein have been prepared in accordance with GAAP 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 Annual Report in Form 10-K for the year ended March 31, 2012 (the "Form 10-K"), as filed with the Securities and Exchange Commission (SEC). Certain information and footnotes normally included in financial statements prepared in accordance with GAAP have been condensed or omitted, although we believe that the disclosures provided in this Form 10-Q 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 period.

Table of Contents

Portfolio Investment Classification

We classify our investments in accordance with the requirements of the 1940 Act. Under the 1940 Act, “Control Investments” are defined as investments in which we own more than 25% of the voting securities or have rights to maintain greater than 50% of the board representation; “Affiliated Investments” are defined as investments in which we own between 5% and 25% of the voting securities; and “Non-Control/Non-Affiliated Investments” are defined as investments that are neither “Control Investments” nor “Affiliated Investments.”

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies followed in the preparation of the consolidated financial statements of CSC, CSVC and CSMC.

Fair Value Measurements We adopted FASB ASC Topic 820 on April 1, 2008. ASC Topic 820 (1) creates a single definition of fair value, (2) establishes a framework for measuring fair value, and (3) expands disclosure requirements about items measured at fair value. The Topic applies to both items recognized and reported at fair value in the financial statements and items disclosed at fair value in the notes to the financial statements. The Topic does not change existing accounting rules governing what can or what must be recognized and reported at fair value in our financial statements, or disclosed at fair value in our notes to financial statements. Additionally, ASC Topic 820 does not eliminate practicability exceptions that exist in accounting pronouncements amended by this Topic when measuring fair value.

Fair value is generally determined based on quoted market prices in the active markets for identical assets or liabilities. If quoted market prices are not available, we use valuation techniques that place greater reliance on observable inputs and less reliance on unobservable inputs. Due to the inherent uncertainty in the valuation process, our estimate of fair value may differ materially from the values that would have been used had a ready market for the securities existed. In addition, changes in the market environment, portfolio company performance and other events may occur over the lives of the investments that may cause the gains or losses ultimately realized on these investments to be materially different than the valuations currently assigned. We determine the fair value of each individual investment and record changes in fair value as unrealized appreciation or depreciation.

Pursuant to our internal valuation process, each portfolio company is valued once a quarter. In addition to our internal valuation process, our Board of Directors retains a nationally recognized firm to provide limited scope third party valuation services on certain portfolio investments at the end of our fiscal year. Our Board of Directors retained Duff & Phelps to provide limited scope third party valuation services on six investments comprising 85.8% of our net asset value at March 31, 2012. For full disclosure of Duff & Phelps’ services, see page 5 of the Form 10-K under the heading “Determination of Net Asset Value and Portfolio Valuation Process.”

We believe our investments at June 30, 2012 and March 31, 2012 approximate fair value based on the market in which we operate and other conditions in existence as of these dates.

Investments Investments are stated at fair value determined by our Board of Directors as described in Notes to the Consolidated Schedule of Investments and Note 3 below. The average cost method is used in determining cost of investments sold. Investments are recorded on a trade date basis.

Table of Contents

Cash and Cash Equivalents Cash and cash equivalents consist of highly liquid investments with an original maturity of three months or less at the date of purchase. Cash and cash equivalents are carried at cost, which approximates fair value.

Segment Information We operate and manage our business in a singular segment. As an investment company, we invest in portfolio companies in various industries and geographic areas as presented in the Consolidated Schedule of Investments.

Use of Estimates The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Interest and Dividend Income Interest and dividend income is recorded on an accrual basis to the extent amounts are expected to be collected. Dividend income is recorded at the ex-dividend date for marketable securities and restricted securities. In accordance with our valuation policy, accrued interest and dividend income is evaluated periodically for collectability. When a debt or loan becomes 90 days or more past due, and if we otherwise do not expect the debtor to be able to service all of its debt or other obligations, we will generally establish a reserve against the interest income, thereby placing the loan or debt security's status on non-accrual basis, and cease to recognize interest income on that loan or debt security until the borrower has demonstrated the ability and intent to pay contractual amounts due. If a loan or debt security's status significantly improves regarding ability to service debt or other obligations, it will be restored to accrual basis.

Federal Income Taxes CSC and CSVC have elected and intend to comply with the requirements of the Internal Revenue Code (IRC) necessary to qualify as regulated investment companies (RICs). By meeting these requirements, they will not be subject to corporate federal income taxes on ordinary income distributed to shareholders. In order to comply as a RIC, each company is required to timely distribute to its shareholders at least 90% of investment taxable income, as defined by the IRC, each year. Taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses. Taxable income generally excludes net unrealized appreciation or depreciation, as investment gains and losses are not included in taxable income until they are realized.

In addition to the requirement that we must annually distribute at least 90% of our investment company taxable income, we may either distribute or retain our realized net capital gains from investments, but any net capital gains not distributed may be subject to corporate level tax. Historically, we have not distributed net capital gains; however, during the quarter ended June 30, 2012 we distributed capital gains dividends in the amount of \$17.59 per share to our shareholders. When we retain the capital gains, they are classified as a "deemed distribution" to our shareholders and are subject to our corporate tax rate of 35%. As an investment company that qualifies as a RIC under the IRC, federal income taxes payable on security gains that we elect to retain are accrued only on the last day of our tax year, December 31. Any capital gains actually distributed to shareholders are generally taxable to the shareholders as long-term capital gains. See Note 4 for further discussion.

CSMC, a wholly owned subsidiary of CSC, is not a RIC and is required to pay taxes at the current corporate rate.

We account for interest and penalties as part of operating expenses. There were no interest or penalties incurred during the three months ended June 30, 2012 and 2011.

Table of Contents

Deferred Taxes CSMC sponsors a qualified defined benefit pension plan which covers its employees and employees of certain of its controlled affiliates. Deferred taxes related to the qualified defined benefit pension plan are recorded as incurred.

Stock-Based Compensation We account for our stock-based compensation using the fair value method, as prescribed by ASC 718, Compensation – Stock Compensation. Accordingly, we recognize stock-based 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. For restricted stock awards, we measured the grant date fair value based upon the market price of our common stock on the date of the grant and will amortize this fair value to share-based compensation expense over the vesting term. See Note 6 for further discussion.

Defined Pension Benefits and Other Postretirement Plans We record annual amounts relating to the defined benefit pension plan based on calculations, which include various actuarial assumptions such as discount rates and assumed rates of return depending on the pension plan. Material changes in pension costs may occur in the future due to changes in the discount rate, changes in the expected long-term rate of return, changes in level of contributions to the plans and other factors. The funded status is the difference between the fair value of plan assets and the benefit obligation. We recognize changes in the funded status of defined benefit plan in the Statement of Assets and Liabilities in the year in which the changes occur and measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end. We presently use March 31 as the measurement date for our defined benefit plan.

Concentration of Risk We place our idle cash in financial institutions, and at times, such balances may be in excess of the federally insured limits. On November 19, 2010, the Federal Deposit Insurance Corporation ("FDIC") issued a Final Rule implementing section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act that provides for unlimited insurance coverage of noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012.

Recent Accounting Pronouncements

In May 2011, the FASB issued Accounting Standards Update ("ASU") 2011-04, Fair Value Measurements (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs ("ASU 2011-04"). ASU 2011-04 results in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. ASU 2011-04 is effective for interim and annual reporting periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a significant impact on our financial condition and results of operations. See Note 3 Investment for further information regarding valuation technique and quantitative information about the significant unobservable inputs utilized by our Company to value Level 3 investments.

3. **INVESTMENTS**

We record our investments at fair value as determined in good faith by our Board of Directors in accordance with GAAP. When available, we base the fair value of our investments on directly observable market prices or on market data derived for comparable assets. For all other investments, inputs used to measure fair value reflect management's best estimate of assumptions that would be used by market participants in pricing the investments in a hypothetical transaction.

Table of Contents

The levels of fair value inputs used to measure our investments are characterized in accordance with the fair value hierarchy established by the Accounting Standard Codification (“ASC”). We use judgment and consider factors specific to the investment in determining the significance of an input to a fair value measurement. While management believes our valuation methodologies are appropriate and consistent with market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. The three levels of the fair value hierarchy and investments that fall into each of the levels are described below:

- Level 1: Investments whose values are based on unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access. We use Level 1 inputs for publicly traded securities. Such investments are valued at the closing price for listed securities and at the lower of the closing bid price or the closing sale price for NASDAQ securities on the valuation date.
- Level 2: Investments whose values are based on observable inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These inputs may include quoted prices for the identical instrument in non-active markets, quoted prices for similar instruments in active markets and similar data. We did not value any of our investments using Level 2 inputs as of June 30, 2012 and 2011.
- Level 3: Investments whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management’s own assumptions about the assumptions a market participant would use in pricing the investment. We use Level 3 inputs for measuring the fair value of approximately 68.7% of our investments.

As required by Topic ASC 820, when the inputs used to measure fair value fall within different levels of the hierarchy, the level within the fair value measurement is categorized based on the lowest level input that is significant to the fair value measurement which may include inputs that are observable (Levels 1 and 2) and unobservable (Level 3). Therefore, gains and losses for such investments categorized within the Level 3 table below may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable (Level 3). We conduct reviews of fair value hierarchy classifications on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification of certain investments.

Unobservable inputs are those inputs for which little or no market data exists and, therefore, require an entity to develop its own assumptions. The fair value determination of each portfolio company requires one or more of the following unobservable inputs:

- Financial information obtained from each portfolio company, including audited and unaudited statements of operations and balance sheets for the most recent period available as compared to budgeted numbers;
 - Current and projected financial condition of the portfolio company;
 - Current and projected ability of the portfolio company to service its debt obligations;

Table of Contents

- Projected operating results of the portfolio company;
- Current information regarding any offers to purchase the investment or recent private sales transactions;
 - Current ability of the portfolio company to raise any additional financing as needed;
- Change in the economic environment which may have a material impact on the operating results of the portfolio company;
 - Qualitative assessment of key management;
 - Contractual rights, obligations or restrictions associated with the investment; and
 - Other factors deemed relevant

Preferred Stock and Common Stock

The significant unobservable inputs used in the fair value measurement of our equity securities are EBITDA multiples, revenue multiples, net book values, tangible book value multiples, and the weighted average cost of capital (“WACC”). Generally, increases or decreases in EBITDA or revenue multiple inputs result in a higher or lower fair value measurement, respectively. Generally, increases or decreases in WACC inputs result in a lower or higher fair value measurement, respectively. However, due to the nature of certain investments, fair value measurements may be based on other criteria, such as third party appraisals. For recent investments, we generally rely on our cost basis to determine the fair value unless fair market value is deemed to have departed from this level.

Debt Securities

The significant unobservable inputs used in the fair value measurement of our debt securities are risk adjusted discount factors used in the yield valuation technique and probability of principal recovery. Significant increase or decrease in any of these valuation inputs in isolation would result in a significantly lower or higher fair value measurement. However, due to the nature of certain investments, fair value measurements may be based on other criteria, such as third party inputs.

Limited Partnership or Limited Liability Company Interests

For recent investments, we evaluate limited partnership or limited liability company interests at cost, which is deemed to represent market value, unless or until there is substantive evidence that cost does not correspond to fair value. Thereafter, these securities are generally valued at our percentage interest of the fund or company's calculated net asset value, unless there is a substantive evidence that the net asset value does not correspond to fair value. All funds are valued in accordance to Topic ASC 820.

Warrants

We generally use the Black-Scholes option pricing model to determine the fair value of warrants held in our portfolio. Option pricing models, including the Black-Scholes model, require the use of subjective inputs, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. In the Black-Scholes model, variation in the expected volatility or expected term assumptions has a significant impact on fair value.

Table of Contents

The table below presents the valuation technique and quantitative information about the significant unobservable inputs utilized by the Company to value our Level 3 investments. Unobservable inputs are those inputs for which little or no market data exists and therefore require an entity to develop its own assumptions. The table is not intended to be all inclusive, but instead captures the significant unobservable inputs relevant to our determination of fair value.

Type	Valuation Technique	Fair Value (in millions)	Unobservable Input	Range	Weighted Average	
Preferred & Common Equity	Market Approach	\$278.0	EBITDA Multiple	3.25x - 6.50x	5.76	x
	Market Approach	\$8.2	Revenue Multiple	1.10x - 3.00x	1.42	x
	Net Book Value	\$5.7	Cash and Asset Value	NA	NA	
	Discounted Cash Flow	\$4.4	Discount Rate	3.32% - 18.00 %	15.35	%
	Market Approach	\$2.3	Multiple of Tangible Book Value	1.00	x	1.00 x
	Market Approach	\$8.3	Recent Transaction Price	NA	NA	
	Market Approach	\$0.2	Market Value of Held Securities	NA	NA	
			\$307.1			
Warrants	Black Scholes Pricing Model	\$0.0	Stock Price	\$0.00	\$0.00	
Debt	Discounted Cash Flow	\$8.9	Discount Rate	11.75% - 17.42 %	16.14	%
	Face Value	\$5.9	Recent Transaction Price	NA	NA	
		\$14.8				
Partnership Interests	Net Asset Value*	\$11.6	Fund Value	NA	NA	
	Total	\$333.5				

*All funds are valued in accordance with ASC 820.

As of June 30, 2012 and March 31, 2012, 68.7% and 56.9%, respectively, of our portfolio investments were categorized as Level 3.

The following fair value hierarchy tables set forth our investment portfolio by level as of June 30, 2012 and March 31, 2012 (in millions):

Asset Category	Total	Fair Value Measurements at 6/30/12 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt	\$14.8	\$-	\$-	\$ 14.8
Partnership Interests	11.6	-	-	11.6

Edgar Filing: CAPITAL SOUTHWEST CORP - Form 10-Q

Preferred Equity	39.3	–	–	39.3
Common Equity	420.0	152.2	–	267.8
Total Investments	\$485.7	\$152.2	\$–	\$ 333.5

25

Table of Contents

Asset Category	Total	Fair Value Measurements at 3/31/12 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt	\$11.2	\$-	\$-	\$ 11.2
Partnership Interests	11.0	-	-	11.0
Preferred Equity	33.9	-	-	33.9
Common Equity	502.4	240.7	-	261.7
Total Investments	\$558.5	\$240.7	\$-	\$ 317.8

The following table provides a summary of changes in the fair value of investments measured using Level 3 inputs during the quarter ended June 30, 2012 (in millions):

	Fair Value 3/31/12	Net Unrealized Appreciation (Depreciation)	Net Changes from Unrealized to Realized	New / Add-On Invest- ments	Divesti- tures	Fair Value 6/30/12
Debt	\$ 11.2	\$ 0.6	\$ -	\$ 3.0	\$ -	\$ 14.8
Partnership Interest	11.0	0.6	-	-	-	11.6
Preferred Equity	33.9	2.2	-	3.2	-	39.3
Common Equity	261.7	6.1	-	-	-	267.8
Total Investments	\$ 317.8	\$ 9.5	\$ -	\$ 6.2	\$ -	\$ 333.5

The total unrealized gains included in earnings that related to assets still held at report date for the three months ended June 30, 2012 and 2011 were \$4,389,243 and \$4,558,159, respectively.

4. INCOME TAXES

We operate to qualify as a RIC under Subchapter M of the IRC. In order to qualify as a RIC, we must annually distribute at least 90% of our taxable ordinary income, based on our tax year, to our shareholders in a timely manner. Ordinary income includes net short-term capital gains but excludes net long-term capital gains. A RIC is not subject to federal income tax on the portion of its ordinary income and long-term capital gains that are distributed to its shareholders, including "deemed distributions" discussed below. As permitted by the Code, a RIC can designate dividends paid in the subsequent tax year as dividends of current year ordinary income and net long-term 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. We have a calendar tax year end of December 31.

We have distributed or intend to distribute sufficient dividends to eliminate taxable income for our completed tax years. If we fail to satisfy the 90% distribution requirement or otherwise fail to qualify as a RIC in any tax year, we would be subject to tax in such year on all of our taxable income, regardless of whether we made any distributions to our shareholders. For the tax year ended December 31, 2011 and 2010, we declared and paid ordinary dividends in the amount of \$3,003,030 and \$2,993,623, respectively.

Table of Contents

Additionally, we are subject to a nondeductible federal excise tax of 4% if we do not distribute at least 98% of our investment company ordinary taxable income before the end of our tax year. For the tax years ended December 31, 2011 and 2010, we distributed 100% of our investment company ordinary taxable income. As a result, we have made no tax provisions for income taxes on ordinary taxable income for the tax years ended December 31, 2011 and 2010.

A RIC may elect to retain its long-term capital gains by designating them as “deemed distribution” to its shareholders and paying a federal tax rate of 35% on the long-term capital gains for the benefit of its shareholders. Shareholders then report their share of the retained capital gains on their income tax returns as if it had been received and report a tax credit for tax paid on their behalf by the RIC. Shareholders then add the amount of the “deemed distribution” net of such tax, to the basis of their shares.

- For the tax year ended December 31, 2011, we had net long-term capital gains of \$3,568,376 for tax purposes and \$4,465,088 for book purposes, which we elected to retain and treat as deemed distributions to our shareholders. For the tax year ended December 31, 2010, we had net long-term capital gains of \$70,221,589 for tax purposes and \$70,325,930 for book purposes, which we elected to retain and treat as deemed distributions to our shareholders. During the quarter ended December 31, 2010 we recorded a \$4,217,985 reduction in the gain on sale of Lifemark Group, Inc. This reduction was the result of a net asset adjustment calculated in accordance with the Stock Purchase Agreement signed on June 10, 2010.
- In order to make the election to retain capital gains, we incurred federal taxes on behalf of our shareholders in the amount of \$1,248,932 for the tax year ended December 31, 2011. For the tax year ended December 31, 2010, we incurred federal taxes on behalf of our shareholders in the amount of \$24,577,557.

For the quarter ended June 30, 2011 and 2012, CSC and 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.

CSMC, a wholly owned subsidiary of CSC, is not a RIC and is required to pay taxes at the current corporate rate. CSMC 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.

5. UNDISTRIBUTED NET REALIZED GAINS (LOSSES) ON INVESTMENTS

Distributions made by RICs often differ from aggregate GAAP-basis undistributed net investment income and accumulated net realized gains (total GAAP-basis net realized gains). The principal cause is that required minimum fund distributions are based on income and gain amounts determined in accordance with federal income tax regulations, rather than GAAP. The differences created can be temporary, meaning that they will reverse in the future, or they can be permanent. In subsequent periods, when all or a portion of a temporary difference becomes a permanent difference, the amount of the permanent difference will be reclassified to “additional capital.”

Table of Contents

We incur federal taxes on behalf of our shareholders as a result of our election to retain long-term capital gains. We had \$560,689 and \$498,438 of undistributed long term capital gains, as of June 30, 2012 and March 31, 2012, respectively.

During the quarter ended June 30, 2012, we distributed \$17.59 per share to our shareholders. This distribution is generally taxable to the shareholders as a long term capital gain.

6. EMPLOYEE STOCK OPTION PLANS

On July 20, 2009, shareholders approved our 2009 Stock Incentive Plan (the “2009 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 up to ten years from the date of grant and are generally exercisable on or after the first anniversary of the date of grant in five annual installments. Options to purchase 38,750 shares at a price of \$76.74 (market price at the time of the grant) were granted on October 19, 2009. Additionally, options to purchase 20,000 shares at a price of \$95.79 (market price at time of the grant) were granted on March 22, 2010, options to purchase 15,000 shares at a price of \$88.20 were granted on July 19, 2010 and options to purchase 10,000 shares at a price of \$96.92 were granted on July 18, 2011. During the quarter ended June 30, 2012, 18,800 options were exercised and 4,000 options were forfeited, thus leaving 60,950 options outstanding and 60,250 options available for grant under the 2009 Plan.

We previously granted stock options under our 1999 Stock Option Plan (the “1999 Plan”), as approved by shareholders on July 19, 1999. The 1999 Plan expired on April 19, 2009. Options previously made under our 1999 Stock Option Plan and outstanding on July 20, 2009 continue in effect governed by provisions of the 1999 Plan. All options granted under the 1999 Plan were granted at or above market price, generally expire up to 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.

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 quarters ended June 30, 2012 and 2011, we recognized compensation expense of \$224,770 and \$244,650, respectively.

As of June 30, 2012, the total remaining unrecognized compensation cost related to non-vested stock options was \$1,774,717, which will be amortized over the remaining weighted average service period of approximately 2.0 years.

Table of Contents

The following table summarizes the 2009 Plan and the 1999 Plan price per option at grant date using the Black-Scholes pricing model:

Date of Issuance	Weighted Average Fair Value	Expected Dividend Yield	Black-Scholes Pricing Model Assumptions				Expected Volatility	Expected Life (in years)
			Risk- Free Interest Rate					
2009 Plan								
July 18, 2011	\$ 33.07	0.83 %	1.45 %		40.0 %		5	
July 19, 2010	\$ 28.58	0.91 %	1.73 %		37.5 %		5	
March 22, 2010	\$ 32.56	0.84 %	2.43 %		37.8 %		5	
October 19, 2009	\$ 25.36	1.04 %	2.36 %		37.6 %		5	
1999 Plan								
July 30, 2008	\$ 29.93	0.62 %	3.36 %		20.2 %		5	
July 21, 2008	\$ 27.35	0.67 %	3.41 %		20.2 %		5	
July 16, 2007	\$ 41.78	0.39 %	4.95 %		19.9 %		5	
July 17, 2006	\$ 33.05	0.61 %	5.04 %		21.2 %		7	
May 15, 2006	\$ 31.28	0.64 %	5.08 %		21.1 %		7	

The following table summarizes activity in the 2009 Plan and the 1999 Plan as of June 30, 2012:

	Number of Shares	Weighted Average Exercise Price
2009 Plan		
Balance at March 31, 2011	73,750	\$ 84.24
Granted	10,000	96.92
Exercised	—	—
Canceled	—	—
Balance at March 31, 2012	83,750	\$ 85.75
Granted	—	—
Exercised	(18,800)	78.87
Canceled	(4,000)	88.20
Balance at June 30, 2012	60,950	\$ 87.71
1999 Plan		
Balance at March 31, 2011	96,500	\$ 114.78
Granted	—	—
Exercised	(1,500)	65.70
Canceled	—	—
Balance at March 31, 2012	95,000	\$ 113.63
Granted	—	—
Exercised	16,090	95.36
Canceled	—	—
Balance at June 30, 2012	78,910	\$ 126.79

Combined Balance at June 30, 2012	139,860	\$	107.55
-----------------------------------	---------	----	--------

Table of Contents

June 30, 2012	Weighted Average Aggregate Intrinsic Remaining Contractual Term	Value
Outstanding	2.0 years	\$ 4,306,842
Exercisable	1.2 years	\$ 1,833,046

At June 30, 2012, the range of exercise prices and weighted-average remaining contractual life of outstanding options was \$76.74 to \$152.98 and 2.0 years, respectively. The number of options exercisable under the 2009 Plan and the 1999 Plan at June 30, 2012 and 2011, was 55,200 with a weighted-average exercise price of \$127.69 and 61,825 with a weighted-average exercise price of \$113.04, respectively. During the quarter ended June 30, 2012, 34,890 options were exercised. There were no options exercised during the quarter ended June 30, 2011.

Stock Awards

On January 15, 2012, our Board of Directors approved the issuance of 47,000 shares of restricted stock to certain key employees pursuant to the Capital Southwest Corporation 2010 Restricted Stock Award Plan. A restricted stock award is an award of shares of our common stock (which have full voting and dividend rights but are restricted with regard to sale or transfer), the restrictions over which lapse ratably over a specified period of time (generally five years). Restricted stock awards are independent of stock option grants and are subject to forfeit if employment terminates prior to these restrictions lapsing. These shares vest over a five-year period from the grant date and are expensed over the five-year service period starting on the grant date. The following table summarizes the restricted stock available for issuance as of June 30, 2012:

Restricted stock available for issuance as of March 31, 2012	37,350
Less restricted stock forfeited during the quarter ended June 30, 2012:	1,000
Restricted stock available for issuance as of June 30, 2012	36,350

We expense the cost of the restricted stock awards, which is determined to equal the fair value of the restricted stock award at the date of the grant on a straight-line basis over the vesting period in which the restrictions on these stock awards lapse. For these purposes, the fair value of the restricted stock award is determined based on the closing price of our common stock on the date of grant. For the quarter ended June 30, 2012, we recognized total share based compensation expense of \$31,997 related to the restricted stock issued to our employees and officers. For the quarter ended June 30, 2011, no restricted stock was issued.

As of June 30, 2012, the total remaining unrecognized compensation cost related to non-vested restricted stock awards was \$650,826, which will be amortized over the weighted-average service period of approximately 4.5 years.

Table of Contents

The following table represents a summary of the activity for our restricted stock awards for the fiscal year ended June 30, 2012:

Restricted Stock Awards	Number of Shares	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (in Years)
Unvested at March 31, 2012	9,650	\$ 83.60	4.8
Granted	–	–	–
Vested	–	–	–
Forfeited or expired	1,000	\$ 83.60	–
Unvested at June 30, 2012	8,650	\$ 83.60	4.5

Phantom Stock Plan

On January 16, 2012, our Board of Directors approved the issuance of 26,000 phantom stock options to certain key employees pursuant to the Capital Southwest Corporation Phantom Stock Option Plan to provide deferred compensation to certain key employees. Under the plan, awards vest on the fifth anniversary of the award date. Upon exercise of the phantom option, a cash payment in an amount for each Phantom share equal to estimated fair market value minus the phantom option exercise price will be distributed to plan participants. The exercise price of each phantom share is \$146.95 (Net Asset Value at December 31, 2011), and estimated fair market value of phantom stock awards is calculated based on our net asset value, as of December 31 of each year.

The following table represents a summary of the activity for our phantom stock plan for the fiscal year ended June 30, 2012:

Phantom Stock Awards	Number of Shares	Exercise Price Per Share	Weighted Average Remaining Vesting Term (in Years)
Unvested at March 31, 2012	26,000	\$ 146.95	4.8
Granted	–	–	–
Vested	–	–	–
Forfeited or expired	2,500	\$ 146.95	–
Unvested at June 30, 2012	23,500	\$ 146.95	4.5

7. COMMITMENTS

From time to time the Company may be liable for claims against its portfolio companies. We do not believe the effects of such claims would have a material impact on our results of operations and financial condition.

CSC has agreed, subject to certain conditions, to invest up to \$10,138,169 in nine portfolio companies as of June 30, 2012.

On June 28, 2012, we completed a \$5,950,000 investment in TitanLiner, Inc. The transaction was funded on July 2, 2012, leaving a commitment payable of \$5,950,000 at June 30, 2012.

Table of Contents

8. SUMMARY OF PER SHARE INFORMATION

The following presents a summary of per share data for the three months ended June 30, 2012 and 2011.

Per Share Data	Three Months Ended June 30,	
	2012	2011
Investment income	\$.38	\$.32
Operating expenses	(.37)	(.31)
Income taxes	(.01)	(.01)
Net investment income	.00	.00
Distributions from undistributed net investment income	(.40)	(.40)
Net realized gain net of tax	17.61	(1.58)
Net decrease in unrealized appreciation of investments	(20.67)	(1.21)
Distribution from Undistributed net realized gains	(17.59)	-
Capital Share transactions:		
Exercise of employee stock options	(0.74)	-
Stock option expense	.07	.07
Decrease in net asset value	(21.72)	(3.12)
Net asset value		
Beginning of period	167.45	143.68
End of period	\$ 145.73	\$ 140.56

Item 2. – Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our financial statements and the notes thereto included elsewhere in our Annual Report on Form 10-K for the fiscal year ended March 31, 2012 (the "Form 10-K").

The information contained herein may contain "forward-looking statements" based on our current expectations, assumptions and estimates about us and our industry. These forward-looking statements involve risks and uncertainties. Words such as "believe," "anticipate," "estimate," "expect," "intend," "plan," "will," "may," "might," "could," other similar expressions identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of several factors more fully described in "Risk Factors" and elsewhere in this Form 10-Q, and in our Form 10-K for the year ended March 31, 2012. The forward-looking statements made in this Form 10-Q related only to events as of the date on which the statements are made. You should read the following discussion in conjunction with the consolidated financial statements and related footnotes and other financial information included in our Form 10-K for the year ended March 31, 2012. We undertake no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

Table of Contents

Results of Operations

The composite measure of our financial performance in the Consolidated Statements of Operations is captioned “Increase in net assets from operations” and consists of three elements. The first is “Net investment income,” which is the difference between income from interest, dividends and fees and its combined operating and interest expenses, net of applicable income taxes. The second element is “Net realized gain (loss) on investments,” which is the difference between the proceeds received from disposition of portfolio securities and their stated cost, net of applicable income tax expense based on the Company’s tax year. The third element is the “Net increase in unrealized appreciation of investments,” which is the net change in the market or fair value of the Company’s investment portfolio, compared with stated cost. It should be noted that the “Net realized gain (loss) on investments” and “Net increase in unrealized appreciation of investments” are directly related in that when an appreciated portfolio security is sold to realize a gain, a corresponding decrease in net unrealized appreciation occurs by transferring the gain associated with the transaction from being “unrealized” to being “realized.” Conversely, when a loss is realized on a depreciated portfolio security, an increase in net unrealized appreciation occurs.

Net Investment Income

For the three months ended June 30, 2012, total investment income was \$1,450,865, a \$254,189, or 21.2%, increase from the \$1,196,676 total investment income for the three months ended June 30, 2011. This comparable period increase was primarily attributable to CapitalSouth Partners Fund III, L.P.’s distribution of profits of \$104,053 during the first quarter of 2012.

The Company’s principal objective is to achieve capital appreciation. Therefore, a significant portion of the investment portfolio is structured to maximize the potential return from equity participation and provides minimal current yield in the form of interest or dividends. The Company also earns interest income from the short-term investment of cash funds, and the annual amount of such income varies based upon the average level of funds invested during the year and fluctuations in short-term interest rates. During the three months ended June 30, 2012 and 2011, the Company also had interest income from temporary cash investments of \$20,418 and \$10,273, respectively.

The Company also receives management fees primarily from its controlled affiliates, which aggregated \$143,950 and \$132,200 for the three months ended June 30, 2012 and 2011, respectively.

During the three months ended June 30, 2012 and 2011, the Company recorded dividend income from the following sources:

	Three Months Ended	
	June 30,	
	2012	2011
Alamo Group, Inc.	\$ 169,818	\$ 169,818
Encore Wire Corporation	81,735	81,735
The RectorSeal Corporation	240,000	240,000
TCI Holdings, Inc.	20,318	20,318
The Whitmore Manufacturing Company	60,000	60,000
	\$ 571,871	\$ 571,871

Due to the nature of its business, the majority of the Company’s operating expenses are related to employee and director compensation, office expenses, legal, professional and accounting fees and the net pension benefit. Total operating expenses, increased by \$253,408 or 21.7% during the three months ended June 30, 2012 as compared to the quarter ended June 30, 2011. The increase in 2012 is primarily due to compensation adjustments which went into

effect in July 2011 as well as staff growth.

33

Table of Contents

Net Realized Gain (Loss) on Investments

During the quarter ended June 30, 2012, we sold 2,774,250 shares of common stock in Encore Wire Corporation held by our subsidiary, CSVC, to Encore Wire generating a capital gain of \$66,037,485. We also sold 50,000 shares of common stock of Hologic, Inc. generating a capital gain of \$850,548. In addition, we declared and paid a cash dividend in the amount of \$17.59 per share of common stock. As a result, we have undistributed net realized gains of \$62,251 during the first quarter ended June 30, 2012.

During the quarter ended June 30, 2011, we sold all of our shares of preferred stock (Series A, Series B and Series C) in Phi Health, Inc, generating net cash proceeds of \$38,959. As a result, we recognized net realized losses of \$5,910,655.

Management does not attempt to maintain a consistent level of realized gains from year to year, but instead attempts to maximize total investment portfolio appreciation. This strategy often dictates the long-term holding of portfolio securities in pursuit of increased values and increased unrealized appreciation, but may at opportune times dictate realizing gains or losses through the disposition of certain portfolio investments.

Net Increase/(Decrease) in Unrealized Appreciation of Investments

For the quarter ended June 30, 2012, we recognized a \$78,521,467 decrease in net change in unrealized appreciation of investments. The largest decreases in unrealized appreciation are attributable to Encore Wire Corporation, which decreased \$85,722,585 primarily due to our recent sales of CSVC's interest in Encore Wire Corporation as well as a decline in their stock price; Heelys, Inc. decreased \$2,702,020 attributable to decreases in stock price; Hologic, Inc. decreased \$3,105,727 attributable primarily to recent sales of 50,000 shares as well as a decrease in stock price at June 30, 2012; and Media Recovery, Inc. decreased 3,300,000 due to slowdowns in their respective business segments. Offsetting these decreases were Alamo Group, Inc. which increased \$3,663,258 due to an increase in stock price; The Rectorseal Corporation, which increased \$7,500,000; KBI Biopharma, which increased \$1,500,000; The Whitmore Manufacturing Company, which increased \$1,000,000; Cinatra Clean Technologies, Inc., which increased \$573,607; and Instawares Holding Company, LLC. increased \$574,000. All of these increases were attributable to increases in the entities' respective earnings.

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

	Three Months Ended	
	June 30,	
	2012	2011
Alamo Group, Inc.	\$ 3,663,258	\$ (8,452,900)
Cinatra Clean Technologies, Inc.	573,607	-
Encore Wire Corporation	(85,722,585)	7,151,813
Heelys, Inc	(2,702,020)	(326,106)
Hologic, Inc.	(3,105,727)	(1,278,297)
Instawares Holding Company, LLC	574,000	-
KBI Biopharma, Inc.	1,500,000	(2,600,000)
Media Recovery, Inc.	(3,300,000)	(4,200,000)
The RectorSeal Corporation	7,500,000	200,000
The Whitmore Manufacturing Company	1,000,000	3,800,000

A description of the investments listed above and other material components of the investment portfolio are included elsewhere in this report under the caption “Consolidated Schedule of Investments – June 30, 2012 and March 31, 2012.”

Table of Contents

Portfolio Investments

During the quarter ended June 30, 2012, we invested \$5,950,000 into a new investment, TitanLiner Inc., and \$301,046 in existing portfolio companies.

We have agreed, subject to certain conditions, to invest up to \$10,138,169 in nine portfolio companies as of June 30, 2012.

Financial Liquidity and Capital Resources

At June 30, 2012, the Company had cash and cash equivalents of approximately \$65.7 million. Pursuant to the SBA regulations, cash and cash equivalents of \$2.7 million held by CSVC may not be transferred or advanced to CSC without the consent of the SBA.

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

Application of Critical Accounting Policies and Accounting Estimates

There have been no changes during the quarter ended June 30, 2012 to the critical accounting policies or the area that involve the use of significant judgments or estimates we described in our Annual Report on Form 10-K for the fiscal year ended March 31, 2012.

Item 3. Quantitative and Qualitative Disclosures 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 basic 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 and on our net asset value.

Our investment in portfolio securities includes fixed-rate debt securities which totaled \$14,782,001 at June 30, 2012, equivalent to 3.0% 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.

Table of Contents

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 traded 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 unrestricted, freely marketable common stock of publicly traded companies. These freely marketable investments, which are valued at the public market price, are directly exposed to equity price risks because a change in an issuer's public market equity price would result in an identical change in the value of our investment in such security.

Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of our management, including the Chairman of the Board and President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15 of the Securities Exchange Act of 1934). Based upon this evaluation, our Chairman of the Board and President and Chief Financial Officer have concluded that our current disclosure controls and procedures are effective in timely alerting them of material information relating to us that is required to be disclosed in the reports we file or submit under Securities Exchange Act of 1934.

During the fiscal quarter ended June 30, 2012, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

PART II. – OTHER INFORMATION

Item 1. Legal Proceedings

We may, from time to time, be involved in litigation arising out of our operations in the normal course of business or otherwise. Furthermore, third parties may try to seek to impose liability on us in connection with the activities of our portfolio companies. We have no current pending legal proceedings to which we are party or to which any of our assets is subject.

Item 1A. Risk Factors

There have been no material changes to our risk factors disclosed in Item 1A. "Risk Factors", in our Annual Report on Form 10-K for the fiscal year ended March 31, 2012.

Item 6. Exhibits

Exhibit No. Description

<u>31.1</u>	Certification of Chairman of the Board and President required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), filed herewith.
<u>31.2</u>	Certification of Chief Financial Officer required by Rule 13a-14(a) of the Exchange Act, filed herewith.
<u>32.1</u>	Certification of Chairman of the Board and President required by Rule 13a-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code, furnished herewith.
<u>32.2</u>	Certification of Chief Financial Officer required by Rule 13a-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code, furnished herewith.

Table of Contents

SIGNATURES

Pursuant to the requirements 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

August 6, 2012
Date

By:

/s/ Gary L. Martin
Gary L. Martin
Chairman of the Board and President

August 6, 2012
Date

By:

/s/ Tracy L. Morris
Tracy L. Morris
Chief Financial Officer