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CAPITAL SOUTHWEST CORP
Form 10-Q
August 04, 2006

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, 2006

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 75-1072796
(State or other jurisdiction of incorporation (I.R.S. Employer
or organization) 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 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 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.

3,875,751 shares of Common Stock, \$1 Par Value as of July 31, 2006

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES
Consolidated Statements of Financial Condition

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Assets	June 30, 2006 ----- (Unaudited)	March 31, 2006 -----
Investments at market or fair value		
Companies more than 25% owned		
(Cost: June 30, 2006 - \$38,149,866		
March 31, 2006 - \$23,114,866)	\$364,627,985	\$298,481,983
Companies 5% to 25% owned		
(Cost: June 30, 2006 - \$18,595,746,		
March 31, 2006 - \$18,595,746)	98,835,850	92,070,852
Companies less than 5% owned		
(Cost: June 30, 2006 - \$31,448,899,		
March 31, 2006 - \$46,886,344)	81,344,323	159,875,248
	-----	-----
Total investments		
(Cost: June 30, 2006- \$88,194,511		
March 31, 2006 - \$88,596,956)	544,808,158	550,428,083
Cash and cash equivalents	162,932,468	11,503,866
Receivables	151,758	135,887
Other assets	7,364,666	7,300,297
	-----	-----
Totals	\$715,257,050	\$569,368,133
	=====	=====
 Liabilities and Shareholders' Equity		
Notes payable to bank	\$158,000,000	\$ 8,000,000
Accrued interest and other liabilities	1,575,141	1,697,086
Income taxes payable	1,121,609	982,653
Deferred income taxes	159,885,485	162,070,285
	-----	-----
Total liabilities	320,582,235	172,750,024
	-----	-----
 Shareholders' equity		
Common stock, \$1 par value: authorized,		
5,000,000 shares; issued, 4,313,116 shares		
at June 30, 2006 and 4,297,616 shares at		
March 31, 2006	4,313,116	4,297,616
Additional capital	9,195,917	8,109,797
Undistributed net investment income	3,464,336	3,744,830
Undistributed net realized gain on investments	86,690,100	86,432,040
Unrealized appreciation of investments -		
net of deferred income taxes	298,044,648	301,067,128
Treasury stock - at cost (437,365 shares)	(7,033,302)	(7,033,302)
	-----	-----
Net assets at market or fair value, equivalent		
to \$101.83 per share at June 30, 2006 on the		
3,875,751 shares outstanding and \$102.74		
per share at March 31, 2006 on the		
3,860,251 shares outstanding	394,674,815	396,618,109
	-----	-----
Totals	\$715,257,050	\$569,368,133
	=====	=====

(See Notes to Consolidated Financial Statements)

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CAPITAL SOUTHWEST CORPORATION
AND SUBSIDIARIES
Consolidated Statements of Operations

(Unaudited)

	Three Months Ended June 30	
	2006	2005
Investment income:		
Interest	\$ 205,852	\$ 141,903
Dividends	782,566	782,246
Management and directors' fees	198,450	170,750
	1,186,868	1,094,899
Operating expenses:		
Salaries	343,465	233,000
Net pension benefit	(29,187)	(63,717)
Other operating expenses	221,228	202,458
	535,506	371,741
Income before interest expense and income taxes	651,362	723,158
Interest expense	146,982	118,759
Income before income taxes	504,380	604,399
Income tax expense	12,824	29,700
Net investment income	\$ 491,556	\$ 574,699
Proceeds from disposition of investments	\$ 397,016	\$ 6,884,240
Cost of investments sold	--	1,623,656
Realized gain on investments before income taxes	397,016	5,260,584
Income tax expense	138,956	1,851,605
Net realized gain on investments	258,060	3,408,979
Increase (decrease) in unrealized appreciation of investments before income taxes	(5,217,480)	4,141,571
Increase (decrease) in deferred income taxes on appreciation of investments	(2,195,000)	1,450,000
Net increase (decrease) in unrealized appreciation of investments	(3,022,480)	2,691,571
Net realized and unrealized gain (loss) on investments	\$ (2,764,420)	\$ 6,100,550

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Increase (decrease) in net assets from operations	\$ (2,272,864)	\$ 6,675,249
	=====	=====

(See Notes to Consolidated Financial Statements)

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

	Three Months Ended June 30, 2006 ----- (Unaudited)	Year Ended March 31, 2006 -----
Operations		
Net investment income	\$ 491,556	\$ 2,389,256
Net realized gain on investments	258,060	13,115,874
Net increase (decrease) in unrealized appreciation of investments	(3,022,480)	80,685,303
	-----	-----
Increase (decrease) in net assets from operations	(2,272,864)	96,190,433
Distributions from:		
Undistributed net investment income	(772,050)	(2,314,231)
Capital share transactions		
Exercise of employee stock options	1,097,500	208,000
Stock option expense	4,120	--
	-----	-----
Increase (decrease) in net assets	(1,943,294)	94,084,202
Net assets, beginning of period	396,618,109	302,533,907
	-----	-----
Net assets, end of period	\$394,674,815	\$396,618,109
	=====	=====

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(See Notes to Consolidated Financial Statements)

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CAPITAL SOUTHWEST CORPORATION
AND SUBSIDIARIES
Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended June 30	
	2006	2005
	-----	-----
Cash flows from operating activities		
Increase (decrease) in net assets from operations	\$ (2,272,864)	\$ 6,675,249
Adjustments to reconcile increase (decrease) in net assets from operations to net cash provided by operating activities:		
Proceeds from disposition of investments	397,016	6,884,240
Purchases of securities	--	(2,805,201)
Maturities of securities	402,445	--
Depreciation and amortization	3,865	3,925
Net pension benefit	(29,187)	(63,717)
Realized gain on investments before income taxes	(397,016)	(5,260,584)
Deferred taxes on realized gain on investments	138,956	1,851,605
Net (increase) decrease in unrealized appreciation of investments	3,022,480	(2,691,571)
Stock option expense	4,120	--
Increase in receivables	(15,871)	(78,223)
(Increase) decrease in other assets	(19,943)	5,425
Decrease in accrued interest and other liabilities	(106,582)	(159,435)
Decrease in accrued pension cost	(34,467)	(38,668)
Deferred income taxes	10,200	22,200
	-----	-----
Net cash provided by operating activities	1,103,152	4,345,245
	-----	-----
Cash flows from financing activities		
Increase in notes payable to bank	150,000,000	--
Decrease in note payable to portfolio company	--	(5,000,000)
Distributions from undistributed net investment income	(772,050)	(771,410)
Proceeds from exercise of employee stock options	1,097,500	--
	-----	-----
Net cash provided by (used in) financing activities	150,325,450	(5,771,410)
	-----	-----
Net increase (decrease) in cash and cash equivalents	151,428,602	(1,426,165)
Cash and cash equivalents at beginning		

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of period	11,503,866	5,104,935
	-----	-----
Cash and cash equivalents at end of period	\$162,932,468	\$ 3,678,770
	=====	=====

Supplemental disclosure of cash flow information:

Cash paid during the period for:

Interest	\$123,763	\$118,681
Income taxes	\$ 20,000	\$ 7,500

(See Notes to Consolidated Financial Statements)

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CAPITAL SOUTHWEST CORPORATION
AND SUBSIDIARIES
Notes to Consolidated Financial Statements

(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 annual report on Form 10-K for the year ended March 31, 2006. 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. Stock-Based Compensation

Effective April 1, 2003, we adopted the fair value method of recording compensation expense related to all stock options granted after March 31, 2003, in accordance with Financial Accounting Standards ("FASB") Statement Nos. 123 and 148. The only options granted during this period were on July 19, 2004 to a new investment associate who resigned on December 31, 2004 with no options vested.

In December 2004, the FASB issued SFAS No. 123 (revised 2004),

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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 will 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 will be expensed over the vesting period of the related stock options. Accordingly, for the quarter ended June 30, 2006 we recognized compensation expense of \$4,120.

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Notes to Consolidated Financial Statements (continued)

SFAS 123 R also requires the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow. As a regulated investment company, we are subject to no tax effect as the majority of our options granted are incentive stock options and our net investment income equals the dividends that we pay out. Therefore, we do not incur any tax expense.

The following table illustrates the effect on net asset value and net asset value per share for the three months ended June 30, 2005 if we had applied the fair value recognition provisions of FASB Statement No. 123 to stock-based compensation for options granted prior to the implementation of FASB Statement No. 123.

	June 30, 2006	June 30, 2005
	-----	-----
Net asset value, as reported	\$394,674,815	\$308,437,746
Deduct: Total fair value computed stock-based compensation	--	37,734
	-----	-----
Pro forma net asset value	\$394,674,815	\$308,400,012
	=====	=====
 Net asset value per share:		
Basic - as reported	\$101.83	\$79.97
	=====	=====
Basic - pro forma	\$ --	\$79.96
	=====	=====
Diluted - as reported	\$101.71	\$79.89
	=====	=====

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Diluted - pro forma	\$ --	\$79.88
	=====	=====

As of June 30, 2006, the total remaining unrecognized compensation cost related to non-vested stock options was \$1,096,333, which will be amortized over the weighted-average service period of approximately 8.41 years.

3. 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 the exercise of such options for up to 140,000 shares of common stock. All options are granted at or above market price and 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 June 30, 2006, there were 66,000 shares available for grant under the Plan. The per share weighted-average fair value of the stock options granted on May 15, 2006 was \$31.276 per option using the Black-Scholes pricing model with the following assumptions: expected dividend yield of .64%, risk-free interest rate of 5.08%, expected volatility of 21.1%, and expected life of 7 years.

The following summarizes activity in the stock option plan since March 31, 2006:

	Number of shares -----	Weighted-Average Exercise Price -----
Balance at March 31, 2006	45,300	\$68.411
Granted	50,000	93.490
Exercised	(15,500)	70.806
Canceled	(24,500)	89.482
	-----	-----
Balance at June 30, 2006	55,300	81.080
	=====	=====

At June 30, 2006, the range of exercise prices and weighted-average remaining contractual life of outstanding options was \$65.00 to \$93.49 and 7.63 years, respectively. The total intrinsic value of options exercised during the

Notes to Consolidated Financial Statements (continued)

three months ended June 30, 2006 was \$349,636 with the exercise prices ranging from \$65.00 to \$77.00 per share. New shares were issued for the \$1,097,500 cash received from option exercises for the three months ended June 30, 2006.

At June 30, 2006, the number of options exercisable was 14,000 and the weighted-average exercise price of those options was \$67.01.

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On July 17, 2006, a stock option to purchase 7,500 shares of common stock was issued to a new investment associate who joined the company on July 12, 2006.

4. Summary of Per Share Information

	Three Months Ended June 30	
	2006	2005
Investment income	\$.31	\$.28
Operating expenses	(.14)	(.09)
Interest expense	(.04)	(.03)
Income taxes	--	(.01)
	.13	.15
Net investment income	.13	.15
Distributions from undistributed net investment income	(.20)	(.20)
Net realized gain on investments	.07	.88
Net increase (decrease) in unrealized appreciation of investments after deferred taxes	(.78)	.70
Exercise of employee stock options*	(.13)	--
Stock option expense	--	--
	(.91)	1.53
Increase (decrease) in net asset value	(.91)	1.53
Net asset value:		
Beginning of period	102.74	78.44
	\$101.83	\$79.97
End of period	\$101.83	\$79.97
	\$101.83	\$79.97
Increase (decrease) in deferred taxes on unrealized appreciation	\$ (.74)	\$ 0.37
Deferred taxes on unrealized appreciation:		
Beginning of period	41.65	30.36
	\$ 40.91	\$30.73
End of period	\$ 40.91	\$30.73
	\$ 40.91	\$30.73
Shares outstanding at end of period (000s omitted)	3,875	3,857

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

5. Recent Accounting Pronouncements

The Financial Accounting Standards Board (FASB) has issued Interpretation No. 48 (FIN48), which clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We have evaluated the positions in the tax returns we have filed and do not believe that FIN 48 will have a material impact on our financial statements.

The state of Texas recently passed House Bill 3 (HB3), which revises the existing franchise tax system to create a new tax on virtually all Texas businesses. Starting in the fiscal year 2007, HB3 changes the franchise tax base,

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lowers the tax rate and extends coverage to active businesses receiving state law liability protection. We have been subject to an immaterial amount of Texas franchise taxes and expect the HB3 to have some affect, but have not determined the extent of this impact.

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

Net asset value at June 30, 2006 was \$394,674,815, equivalent to \$101.83 per share after deducting an allowance of \$40.91 per share for deferred taxes on net unrealized appreciation of investments. Assuming reinvestment of all dividends and tax credits on retained long-term capital gains, this represents a decrease of 0.7% during the past three months and an increase of 29.9% during the past twelve months.

	June 30, 2006	June 30, 2005
	-----	-----
Net assets	\$394,674,815	\$308,437,746
Shares outstanding	3,875,751	3,857,051
Net assets per share	\$101.83	\$79.97

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 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. 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, net of an increase or decrease in deferred income taxes which would become payable if the unrealized appreciation were realized through the sale or other disposition of the investment portfolio. It should be noted that the "Net realized gain 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 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

Interest income of \$205,852 in the three months ended June 30, 2006 increased from \$141,903 in the year-ago period primarily because of an increase in interest rates. During the three months ended June 30, 2006 and 2005, we recorded dividend income from the following sources:

Three Months Ended	
June 30	
2006	2005
-----	-----

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Alamo Group Inc.	\$169,278	\$169,278
Dennis Tool Company	37,499	37,499
Kimberly-Clark Corporation	37,818	34,731
Lifemark Group	150,000	150,000
PalletOne, Inc.	44,921	44,921
The RectorSeal Corporation	240,000	240,000
Sprint Nextel Corporation	2,250	11,250
TCI Holdings, Inc.	20,318	20,318
The Whitmore Manufacturing Company	60,000	60,000
Other	20,482	14,249
	-----	-----
	\$782,566	\$782,246
	=====	=====

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

Net Increase (Decrease) in Unrealized Appreciation of Investments

Set forth in the following table are the significant increases and decreases in unrealized appreciation (before the related change in deferred income taxes and excluding the effect of gains or losses realized during the periods) by portfolio company:

	Three Months Ended June 30	
	----- 2006	2005 -----
Alamo Group Inc.	\$ --	\$(8,463,000)
Encore Wire Corporation	8,174,000	--
Palm Harbor Homes, Inc.	(7,855,000)	11,783,000

During the three months ended June 30, 2006, the value of our investment in Encore Wire Corporation was increased due to an increase in the company's earnings and its stock price. The value of our investment in Palm Harbor Homes, Inc. was decreased due to a less favorable outlook in the manufactured housing industry and a decrease in its stock price. There was no change in the value of our investment in Alamo Group Inc.

Portfolio Investments

During the quarter ended June 30, 2006, we made no additional investments.

We have agreed, subject to certain conditions, to invest up to \$7,191,154 in four portfolio companies.

Financial Liquidity and Capital Resources

At June 30, 2006, we had cash and cash equivalents of approximately \$12.9 million (excluding the \$150 million quarter-end borrowing). Pursuant to Small Business Administration (SBA) regulations, cash and cash equivalents of \$0.6 million held by Capital Southwest Venture Corporation (CSVC) may not be

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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 \$69.7 million. We also have an unsecured \$25.0 million revolving line of credit from a commercial bank, of which \$17.0 million was available at June 30, 2006. With the exception of a capital gain distribution made in the form of a distribution of the stock of a portfolio company in the fiscal year ended March 31, 1996, we have elected to retain all gains realized during the past 38 years. Retention of future gains is viewed as an important source of funds to sustain our investment activity. Approximately \$62.9 million of our investment portfolio is represented by unrestricted publicly-traded securities, and represent a source of liquidity.

On June 30, 2006, we borrowed \$150 million from JPMorgan Chase in order to maintain our tax status as a regulated investment company. On July 3, 2006, we repaid the \$150 million note payable to bank from our cash and cash equivalents.

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.

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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 and on our net asset value.

Our investment in portfolio securities includes fixed rate debt securities which totaled \$5,933,428 at June 30, 2006, equivalent to 1.1% 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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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 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

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 President and Chairman of the Board and Secretary-Treasurer, 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 Chairman of the Board and Secretary-Treasurer concluded that our disclosure controls and procedures are effective to ensure that the information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and is accumulated and communicated to management, including the President and Chairman of the Board and Secretary-Treasurer, as appropriate, to allow timely decisions regarding such disclosure.

During the fiscal quarter ended June 30, 2006, there were no changes to the internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II. OTHER INFORMATION

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 for the fiscal year ended March 31, 2006.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 31.1- Certification of President and Chairman of the Board 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.

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

Exhibit 32.1- Certification of President and Chairman of the Board 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 Secretary-Treasurer 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: August 4, 2006

By: /s/ William R. Thomas

William R. Thomas, President and Chairman
of the Board (chief executive officer)

Date: August 4, 2006

By: /s/ Susan K. Hodgson

Susan K. Hodgson, Secretary-Treasurer
(chief financial/accounting officer)

