XEROX CORP
Form 424B5
August 09, 2004

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Prospectus Supplement

(To Prospectus Dated February 3, 2004)

Filed Pursuant to Rule 424(b)(5)
Registration No. 333-111623

$500,000,000

Xerox Corporation

6 7/8% Senior Notes due 2011

We are offering $500,000,000 aggregate principal amount of our 6 7/8% senior notes due 2011, or the Notes.

The Notes will mature on August 15, 2011. We will pay interest on the Notes on each February 15 and August 15 commencing February 15, 2005.

We may redeem the notes by paying to the holders thereof 100% of the principal amount plus a make-whole redemption premium. Prior to August 15, 2007, we may redeem up to 35% of the Notes with the proceeds of certain equity offerings. If we undergo a change of control, we will be required to offer to purchase all the Notes from the holders.

Certain of the covenants applying to the Notes will be suspended during any time that the Notes have an investment grade rating as more fully described herein. The Notes will not be listed on any securities exchange. Currently, there is no public market for the Notes.

The Notes are required to be guaranteed on a senior basis by only those of our subsidiaries that are required to guarantee our outstanding 9 3/4% Senior Notes due 2009, 7 1/8% Senior Notes due 2010 and 7 5/8% Senior Notes due 2013 upon consummation of this offering. The Notes will be unsecured and will rank senior to all our existing and future subordinated debt and will rank pari passu with our existing and future unsecured senior debt. The Notes will be effectively subordinated to any secured debt of Xerox as well as any secured debt of the guarantor subsidiaries. The Notes will be structurally subordinated to the debt of our subsidiaries that are not guaranteeing the Notes.

Investing in the Notes involves a high degree of risk. See Risk Factors, beginning on page S-5 of this prospectus supplement and on page 2 of the accompanying prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Note	Total
Public Offering Price	100.000%	$ 500,000,000
Underwriting Discount	1.500%	$ 7,500,000
Proceeds to Xerox Corporation (before expenses)	98.500%	$ 492,500,000

Interest on the Notes will accrue from August 10, 2004 to the date of delivery.

The underwriters expect to deliver the Notes to purchasers in book entry form through the Depository Trust Company on or about August 10, 2004.

Joint Book-Running Managers

Citigroup **JPMorgan**

Co-Lead Managers

Bear, Stearns & Co. Inc. **Credit Suisse First Boston**
Deutsche Bank Securities **Merrill Lynch & Co.**

Co-Managers

BNP PARIBAS **Danske Markets** **HSBC**

August 5, 2004

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You should rely only on the information contained in or incorporated by reference into this prospectus supplement and the accompanying prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different or additional information. If anyone provides you with different or additional information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell the Notes in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference is accurate only as of their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.

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ABOUT THIS PROSPECTUS SUPPLEMENT

This document consists of two parts. The first part is this prospectus supplement, which describes the specific terms of this offering. The second part is the accompanying prospectus, which describes more general information, some of which may not apply to this offering. You should read both this prospectus supplement and the accompanying prospectus, together with additional information described below under the heading Where You Can Find More Information.

If the description of the offering varies between this prospectus supplement and the accompanying prospectus, you should rely on the information in this prospectus supplement.

Any statement made in this prospectus supplement or in a document incorporated or deemed to be incorporated by reference in this prospectus supplement will be deemed to be modified or superseded for purposes of this prospectus supplement to the extent that a statement contained in this prospectus supplement or in any other subsequently filed document that is also incorporated or deemed to be incorporated by reference in this prospectus supplement modifies or supersedes that statement. Any statement so modified or superseded will not be deemed, except as so modified or superseded, to constitute a part of this prospectus supplement. See Incorporation of Certain Documents By Reference in the accompanying prospectus.

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the information reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act). In accordance with the Exchange Act, we file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the SEC). Our SEC file number is 1-4471. You can read and copy this information at the following location of the SEC:

Public Reference Room

450 Fifth Street, N.W.

Room 1024

Washington, D.C. 20549

You can also obtain copies of these materials from this public reference room, at prescribed rates. Please call the SEC at 1-800-SEC-0330 for further information on its public reference room. The SEC also maintains a web site that contains reports, proxy statements and other information about issuers, like us, who file electronically with the SEC. The address of that site is *www.sec.gov*.

This prospectus supplement and the accompanying prospectus, which forms a part of the registration statement, do not contain all the information that is included in the registration statement. You will find additional information about us in the registration statement. Any statements made in this prospectus supplement or the accompanying prospectus concerning the provisions of legal documents are not necessarily complete and you should read the documents that are filed as exhibits to the registration statement or otherwise filed with the SEC for a more complete understanding of the document or matter.

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus supplement, the accompanying prospectus and the documents they incorporate by reference may contain certain statements that are not historical fact and which are deemed to be forward-looking. These forward-looking statements and other information are based on our beliefs as well as assumptions made by us using information currently available.

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The words anticipate, believe, estimate, expect, intend, will, and similar expressions, as they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, intended or expected. We do not intend to update these forward-looking statements.

We are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors which could cause actual results to differ materially from those contained in the forward-looking statements. Such events and factors include, but are not limited to, those discussed in the section that follows the heading Risk Factors in this prospectus supplement and the accompanying prospectus, as well as those listed under Forward Looking Statements in the documents enumerated under Incorporation of Certain Documents by Reference including, but not limited to, our Annual Report on Form 10-K for the year ended December 31, 2003, our Quarterly Reports on Form 10-Q for the three months ended March 31, 2004 and June 30, 2004 and under similarly captioned sections in future filings that we make with the SEC under the Exchange Act.

MARKET AND INDUSTRY DATA

Certain market and industry data included or incorporated by reference in this prospectus supplement and in the accompanying prospectus has been obtained from third party sources that we believe to be reliable. We have not independently verified such third party information and cannot assure you of its accuracy or completeness. While we are not aware of any misstatements regarding any market, industry or similar data presented herein, such data involves risks and uncertainties and is subject to change based on various factors, including those discussed under the heading Risk Factors in this prospectus supplement and in the accompanying prospectus.

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Prospectus Supplement Summary

This summary may not contain all the information that may be important to you. You should read this entire prospectus supplement, the accompanying prospectus and those documents incorporated by reference into the prospectus supplement and the accompanying prospectus, including the risk factors and the financial data and related notes, before making an investment decision. References herein to Xerox , the Company , we , us , or our refer to Xerox Corporation and its subsidiaries unless the context specifically states or implies otherwise and, in the context of the Notes, we , us and our shall only refer to Xerox Corporation, the issuer of the Notes.

The Company

We are a technology and services enterprise and a leader in the global document market. We develop, manufacture, market, service and finance a complete range of document equipment, software, solutions and services. We operate in over 130 countries worldwide, and distribute our products in the Western Hemisphere through divisions, wholly-owned subsidiaries and third-party distributors. In Europe, Africa, the Middle East, India and parts of Asia, we distribute our products through Xerox Limited and related companies. We had approximately 61,100 employees at December 31, 2003.

Industry Overview

The document industry is undergoing a fundamental transformation that includes the continuing transition from older light lens devices to digital technology, transition from black and white to color, management of publishing and printing jobs over the internet, use of variable data to create customized documents and an increase in mobile workers utilizing hand-held devices. Documents are increasingly created and stored in digital electronic form and the internet is increasing the amount of information that can be accessed in the form of electronic documents. We believe these trends play to the strengths of our product and service offerings and represent opportunities for future growth. Important areas for growth include color systems in both Office and Production environments, the replacement of multiple single-function office devices with multifunction systems, and the transition of low-end offset printing to digital technology.

Our Position

We develop document technologies, systems, solutions and services intended to improve our customers work processes and business results. Our success rests on our ability to understand our customers needs and provide innovative document management solutions and services that deliver value to them. We deliver value to customers by leveraging core competencies in technology, document knowledge, global sales and service, brand reputation and value added solutions across our three core markets, high-end production environments, small to large networked offices, and services led offerings for large enterprises.

Key Offerings

We compete in both monochrome (i.e. black and white) and color segments by providing a broad range of document products, solutions and services. Our products include printing and publishing systems, digital multifunction devices (which can print, copy, scan and fax), digital copiers, laser and solid ink printers, fax machines, document-management software, and supplies such as toner, paper and ink. We provide software and solutions that can help businesses easily print books or create personalized documents for their customers. In addition, we provide a range of comprehensive document management services, such as operating in-house production centers, developing online document repositories and analyzing how customers can most efficiently create and share documents in the office.

Business Model Highlights

Our business model is based on increasing equipment sales in order to build the population of machines in the field that will produce pages and therefore generate post sale and financing revenue streams. The majority of

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our equipment is sold through sales type leases that are recorded as equipment sale revenue. Equipment sales represent approximately 25 percent of our total revenue. The post sale and financing revenue, which includes service and consumable supplies, is expected to approximate three times the equipment sale revenue over the life of the lease. Accordingly, equipment sale revenue is a key leading indicator of post sale and financing revenue trends as increased machines in the field should lead to increased pages and ultimately increased post sale revenue. The increasing mix of color pages is also of significant importance to post sale revenue as color pages currently generate five times the revenue and profit per page as compared to black and white.

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The Offering

Issuer	Xerox Corporation.
Securities offered	$500,000,000 aggregate principal amount of senior notes due 2011.
Maturity	August 15, 2011.
Interest	6 7/8% per annum, payable semi-annually in arrears on February 15 and August 15 of each year beginning February 15, 2005.
Guarantors	The Notes will be guaranteed on a senior basis by only those of our subsidiaries that guarantee our outstanding 9¾% Senior Notes due 2009, 7 1/8% Senior Notes due 2010 and 7 5/8% Senior Notes due 2013 upon consummation of this offering. The guarantor subsidiaries represent in the aggregate approximately 0% of our consolidated revenues and 1% of our consolidated assets for the six months ended and as of June 30, 2004, respectively. If Xerox cannot make payments on the Notes when they are due, the guarantor subsidiaries must make them instead.
Ranking	The Notes will be unsecured and will rank senior to all our existing and future subordinated debt and will rank *pari passu* with our existing and future unsecured senior debt. The Notes will be effectively subordinated to any secured debt of Xerox as well as any secured debt of the guarantor subsidiaries. The Notes will be structurally subordinated to the debt of our subsidiaries that are not guaranteeing the Notes. As of June 30, 2004, we had $10.3 billion of debt, of which $4.9 billion was secured, $1.8 billion of liabilities to subsidiary trusts issuing preferred securities outstanding, and cash and cash equivalents of $2.5 billion.
	On June 30, 2004, of the $10.3 billion of debt outstanding, our subsidiaries had an aggregate of $7.3 billion of debt outstanding.
Optional redemption	We may redeem some or all of the Notes at any time at 100% of the principal amount plus a make-whole premium. See Description of the Notes Optional Redemption.
	At any time (which may be more than once) before August 15, 2007, we may also redeem up to 35% of the outstanding Notes with money that we raise in one or more equity offerings as long as:

- we pay 106.875% of the face amount of the Notes redeemed, plus accrued and unpaid interest;
- we redeem the Notes within 90 days of completing the equity offering; and
- at least 65% of the aggregate principal amount of the Notes issued remains outstanding afterwards.

Change of Control	If we undergo a change of control, we must give all holders of the Notes the opportunity to sell to us their notes at 101% of their face amount, plus accrued interest.

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	We might not be able to pay to you the required price for Notes that you present to us upon a change of control, because: we might not have enough funds at that time; or the terms of our debt instruments may prevent us from paying.
Certain covenants	The indenture governing the Notes will contain covenants limiting our (and most or all of our subsidiaries) ability to, among other things: incur additional debt; make restricted payments (including paying dividends on our capital stock or redeeming or repurchasing our capital stock or subordinated obligations); make investments; make asset sales; enter into agreements that restrict, among other things, dividends from subsidiaries; grant liens on our assets; engage in transactions with affiliates; and merge or consolidate or transfer substantially all of our assets. The covenants are subject to important exceptions and qualifications, including in particular the exception provided by clause (iii)(x) to the Limitation on Restricted Payments covenant. Most of these covenants applicable to any series of notes will be suspended during any time that such series of notes has investment grade ratings by both Moody s and S&P. However, such covenants will apply and such suspension period will no longer be in effect if and when such series of notes cease to have investment grade ratings from both Moody s and S&P.
Use of proceeds	We will use the net proceeds from this offering for general corporate purposes.
Absence of an Established Market for the Notes	The Notes are a new issue of securities and there is currently no market for them. We do not intend to list the Notes on any securities exchange or to arrange for any quotation system to quote them. We cannot assure you that a liquid market will develop for the Notes.

Risk Factors	An investment in the Notes involves certain risks that you should evaluate prior to making an investment in the Notes. In particular, you should evaluate the specific risk factors under Risk Factors beginning on page S-5 of this prospectus supplement and on page 2 of the accompanying prospectus for a discussion of certain risks involved with an investment in the Notes.

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RISK FACTORS

You should carefully consider the risks described below, the risks set forth in the accompanying prospectus and the other information set forth in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference before making an investment decision. Additional risks and uncertainties not presently known to us, or that we currently deem immaterial, may also impair our business operations. We cannot assure you that any of the events discussed in the risk factors below, or the risk factors in the accompanying prospectus, will not occur. If they do, our business, results of operations or financial condition could be materially adversely affected. In such an instance, the trading price of our securities, including the notes, could decline and you might lose all or part of your investment.

Risks related to the Notes

Our substantial debt could adversely affect our financial health and pose challenges for conducting our business.

We have, and after this offering will continue to have, a substantial amount of debt and other obligations. As of June 30, 2004, on a pro forma basis assuming the consummation of this offering, we would have had $10.8 billion of debt, of which $4.9 billion would have been secured, $1.8 billion of liabilities to subsidiary trusts issuing preferred securities outstanding and cash and cash equivalents of $3.0 billion.

Our substantial debt and other obligations could have important consequences. For example, it could:

- increase our vulnerability to general adverse economic and industry conditions;
- limit our ability to obtain additional financing for future working capital, capital expenditures, acquisitions and other general corporate requirements;
- increase our vulnerability to interest rate fluctuations because a significant portion of our debt has variable interest rates;
- require us to dedicate a substantial portion of our cash flow from operations on our debt and other obligations thereby reducing the availability of our cash flow from operations for other purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- place us at a competitive disadvantage compared to our competitors that have less debt; and
- become due and payable upon a change of control.

If new debt is added to our current debt levels, these related risks could increase.

Our 2003 Credit Facility and the indentures governing our senior notes contain, and certain of our future financing agreements are expected to contain, various covenants which limit the discretion of our management in operating our business and could prevent us from engaging in some beneficial activities.

The indentures governing our outstanding senior notes and our 2003 Credit Facility limit our ability to, among other things, issue debt and preferred stock, retire debt early, make investments and acquisitions, merge, engage in certain transactions with affiliates, create or permit to exist liens, transfer assets, enter into hedging transactions, and pay dividends on our common stock. The 2003 Credit Facility generally does not affect our ability to continue to monetize finance receivables under our agreements with various subsidiaries of General Electric (GE) and others.

Although the terms of the indentures governing our senior notes restrict our ability to incur additional debt to fund significant acquisitions and restricted payments, the indentures permit us and certain of our subsidiaries

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to incur debt in the ordinary course and in other circumstances. The indentures prohibit us from refinancing the 7 1/2% convertible trust preferred securities that we issued in the trust preferred offering in November 2001 if these securities are put to us in December 2004, other than with our equity or junior subordinated debentures or with cash that may be available pursuant to the restricted payments covenant.

The Notes are unsecured and are effectively subordinated to our secured indebtedness.

If Xerox or the guarantors become insolvent or are liquidated, or if payment under any of our secured debt or the guarantors secured debt obligations is accelerated, the secured lenders would be entitled to exercise the remedies available to a secured lender under applicable law and will have a claim on those assets before the holders of our senior notes that are unsecured. As a result, the Notes and related guarantees are effectively subordinated to our and the guarantors secured indebtedness to the extent of the value of the assets securing that indebtedness or the amount of indebtedness secured by those assets. Therefore, the holders of the Notes may recover ratably less than the lenders of our secured debt in the event of our or the guarantors bankruptcy or liquidation. At June 30, 2004, assuming consummation of this offering, we would have had $4.9 billion of secured debt on a consolidated basis, of which $317.0 million would be secured debt of Xerox Corporation and the guarantors. However, in the future, we may be able to refinance our unsecured debt with secured debt, so the amount of assets available to unsecured creditors may decrease.

Your right to receive payments on the Notes could be adversely affected if any of our non-guarantor subsidiaries declares bankruptcy, liquidates or reorganizes.

The Notes are required to be guaranteed on a senior basis by only those of our subsidiaries that are required to guarantee our outstanding 9¾% Senior Notes due 2009, 7 1/8% Senior Notes due 2010 and 7 5/8% Senior Notes due 2013 upon consummation of this offering. Assuming consummation of this offering, at June 30, 2004, our non-guarantor subsidiaries had approximately $7.3 billion of outstanding indebtedness. Our non-guarantor subsidiaries may incur substantial additional indebtedness. In the event of a bankruptcy, liquidation or reorganization of any of the non-guarantor subsidiaries, holders of their indebtedness and their trade creditors will generally be entitled to payment of their claims from the assets of those subsidiaries before any assets are made available for distribution to us or the guarantors.

Federal and state statutes may allow courts to further subordinate or void the guarantees. Federal and state statutes allow courts, under specific circumstances, to void or subordinate guarantees and require note holders to return payments received from guarantors.

Under the federal bankruptcy law and comparable provisions of state fraudulent transfer laws, a guarantee could be voided, or claims in respect of a guarantee could be subordinated to all other debts of that guarantor if, among other things, the guarantor, at the time it incurred the indebtedness evidenced by its guarantee (1) issued the guarantee with the intent of hindering, delaying or defrauding any current or future creditor or contemplated insolvency with a design to favor one or more creditors to the total or partial exclusion of other creditors, or (2) received less than reasonably equivalent value or fair consideration for issuing its guarantee and:

- was insolvent or rendered insolvent by reason of such incurrence;
- was engaged in a business or transaction for which the guarantor s remaining assets constituted unreasonably small capital; or

intended to incur, or believed that it would incur, debts beyond its ability to pay such debts as they mature.

In addition, any payment by that guarantor pursuant to its guarantee could be voided and required to be returned to the guarantor, or to a fund for the benefit of the creditors of the guarantor.

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The measures of insolvency for purposes of these fraudulent transfer laws will vary depending upon the law applied in any proceeding to determine whether a fraudulent transfer has occurred. Generally, however, a guarantor would be considered insolvent if:

- the sum of its debts, including contingent liabilities, were greater than the fair saleable value of all of its assets;
- the present fair saleable value of its assets were less than the amount that would be required to pay its probable liability on its existing debts, including contingent liabilities, as they become absolute and mature; or
- it could not pay its debts as they become due.

On the basis of historical financial information, recent operating history and other factors, we believe that neither we nor the guarantors are insolvent, have unreasonably small capital for the business in which we are engaged or have incurred debts beyond the ability of each of us to pay such debts as they mature. However, we cannot assure you as to what standard a court would apply in making such determination or that a court would agree with our conclusions in this regard.

We may not be able to purchase your Notes upon a change of control.

Upon the occurrence of specified change of control events, we will be required to offer to purchase each holder s Notes at a price equal to 101% of their principal amount plus accrued and unpaid interest. We may not have sufficient financial resources to purchase all of the Notes that holders tender to us upon a change of control offer. The occurrence of a change of control could also constitute an event of default under any of our future debt agreements. See Description of Notes Change of Control.

An active trading market may not develop for the Notes.

The Notes are new securities for which there currently is no established market. We do not intend to apply for the Notes to be listed on any securities exchange or to arrange for the notes to be quoted on any quotation system. Although the underwriters have informed us that they currently intend to make a market in the Notes, they are not obligated to do so and any market may be discontinued at any time without notice. Accordingly, we cannot assure you as to the development or liquidity of any market for any of the Notes. See Underwriting.

Risks related to our business

We face significant competition and our failure to compete successfully could adversely affect our results of operations and financial condition.

We operate in an environment of significant competition, driven by rapid technological advances and the demands of customers to become more efficient. Our competitors range from large international companies to relatively small firms. Some of the large international companies have significant financial resources and compete with us globally to provide document processing products and services in each of the markets we serve. We compete primarily on the basis of technology, performance, price, quality, reliability, brand, distribution and customer service and support. Our success in future performance is largely dependent upon our ability to compete successfully in the markets we currently serve and to expand into additional market segments. To remain competitive, we must develop new products and services and periodically enhance our existing offerings. If we are unable to compete successfully, we could lose market share and important customers to our competitors and that could adversely affect our results of operations and financial condition.

We need to develop and expand the use of color printing and copying.

Increasing the proportion of pages which are printed in color and transitioning color pages currently produced on offset devices to Xerox technology represent key growth opportunities. A significant part of our

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strategy and ultimate success in this changing market is our ability to develop and market technology that produces color prints and copies quickly, easily, with high quality and at reduced cost. Our continuing success in this strategy depends on our ability to make the investments and commit the necessary resources in this highly competitive market, as well as the pace of color adoption by our existing and prospective customers. If we are unable to develop and market advanced and competitive color technologies, we may be unable to capture these opportunities and it could materially adversely affect our results of operations and financial condition.

If we fail to successfully develop new products and technologies, we may be unable to retain and gain customers and our revenues would be reduced.

The process of developing new high technology products and solutions is inherently complex and uncertain. It requires accurate anticipation of customers changing needs and emerging technological trends. We must make long-term investments and commit significant resources before knowing whether these investments will eventually result in products that achieve customer acceptance and generate the revenues required to provide desired returns. If we fail to accurately anticipate and meet our customers needs through the development of new products or if our new products are not widely accepted, we could lose our customers and that could materially adversely affect our results of operations and financial condition.

Our profitability is dependent upon our ability to obtain adequate pricing for our products and to improve our cost structure.

Our success depends on our ability to obtain adequate pricing for our products and services which provides a reasonable return to our shareholders. Depending on competitive market factors, future prices we obtain for our products and services may decline from historical levels. In addition, pricing actions to offset the effect of currency devaluations may not prove sufficient to offset further devaluations or may not hold in the face of customer resistance and/or competition. If we are unable to obtain adequate pricing for our products and services, it could materially adversely affect our results of operations and financial condition.

Our ability to sustain and improve profit margins is largely dependent on our ability to continue to improve the cost efficiency of our operations through such programs as Lean Six Sigma and, to a lesser extent, our ability to complete information technology initiatives. If we are unable to achieve productivity improvements through process re-engineering, design efficiency and supplier and manufacturing cost improvements, our ability to offset labor cost inflation, potential materials cost increases and competitive price pressures would be impaired, all of which could materially adversely affect our results of operations and financial condition.

We have outsourced approximately half of our overall worldwide manufacturing operations and face the risks associated with relying on third party manufactures and external suppliers.

Since 2001, we have outsourced approximately half of our overall worldwide manufacturing operations to Flextronics, Inc. This includes the sale of some of our manufacturing facilities to Flextronics, which has significantly reduced our internal manufacturing capability. Flextronics manufactures and supplies equipment and components, including electronic components, for the Office segment of our business. We expect to increase our purchases from Flextronics commensurate with our future sales. To the extent that we rely on Flextronics and other third party manufacturing relationships, we face the risk that they may not be able to develop manufacturing methods appropriate for our products, they may not be able to quickly respond to changes in customer demand for our products, they may not be able to obtain supplies and materials necessary for the manufacturing process, they may experience labor shortages and/or disruptions, manufacturing costs could be higher than planned and the reliability of our products could decline. If any of these risks were to be realized, and assuming similar third-party manufacturing relationships could not be established, we could experience an interruption in supply or an increase in costs that might result in our being unable to meet customer demand for our products, damage to relationships with our customers, and a reduction in our market share, all of which could materially adversely affect our results of operations and financial condition.

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Our business, results of operations and financial condition may be negatively impacted by economic conditions abroad, including fluctuating foreign currencies and shifting regulatory schemes.

We derive approximately 45% of our revenue from operations outside of the United States. In addition, we manufacture or acquire many of our products and/or their components outside the United States. Our future revenue, cost and results from operations could be adversely affected by a number of factors, including changes in foreign currency exchange rates, as well as by a number of other factors, including changes in economic conditions from country to country, changes in a country s political conditions, trade protection measures, licensing requirements and local tax issues. We generally hedge foreign currency denominated assets, liabilities and anticipated transactions primarily through the use of currency derivative contracts. The use of these derivative contracts tends to mitigate volatility in our results of operations, but does not completely eliminate the volatility. We do not, however, hedge the translation effect of revenues denominated in currencies where the local currency is the functional currency.

Our operating results may be negatively impacted by revenue trends.

Our ability to return to and maintain a consistent trend of revenue growth over the intermediate to longer term is largely dependent upon expansion of our worldwide equipment placements, as well as sales of services and supplies occurring after the initial equipment placement (post sale revenue) in the key growth markets of color and multi-function devices. We expect that revenue growth can be further enhanced through our consulting services in the areas of personalized and product life cycle communications, office and production services and document content and imaging. The ability to achieve growth in our equipment placements is subject to the successful implementation of our initiatives to provide advanced systems, industry-oriented global solutions and services for major customers, improved direct sales productivity and expand our indirect distribution channels in the face of global competition and pricing pressures. Our ability to increase post sale revenue is largely dependent on our ability to increase equipment placements, equipment utilization and color adoption. Equipment placements typically occur through leases with original terms of three to five years. There will be a lag between the increase in equipment placement and an increase in post sale revenues. The ability to grow our customers usage of our products may continue to be adversely impacted by the movement towards distributed printing and electronic substitutes and the impact of lower equipment placements in prior periods. If we are unable to return to and maintain a consistent trend of revenue growth, it could materially adversely affect our results of operations and financial condition.

Our current credit ratings result in higher borrowing costs, which in turn may affect our ability to fund our customer financing activities.

The long-term viability and profitability of our customer financing activities is dependent, in part, on our ability to borrow and the cost of borrowing in the credit markets. This ability and cost, in turn, is dependent on our credit ratings. Our access to the public debt markets is expected to be limited to the non-investment grade segment, which results in higher borrowing costs, until our credit ratings have been restored to investment grade. We are currently funding much of our customer financing activity through third-party financing arrangements, including several with GE in various geographies, cash generated from operations, cash on hand, capital markets offerings and securitizations. There is no assurance that we will be able to continue to fund our customer financing activity at present levels. We continue to negotiate and implement third-party financing programs and actively pursue alternative forms of financing including securitizations and secured borrowings. Our ability to continue to offer customer financing and be successful in the placement of equipment with customers is largely dependent upon maintaining our third party financing arrangements and, longer term, upon having our credit ratings restored to investment grade. If we are unable to continue to offer customer financing, it could materially adversely affect our results of operations and financial condition.

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We need to maintain adequate liquidity in order to have sufficient cash to meet operating cash flow requirements and to repay maturing debt and other obligations. If we fail to comply with the covenants contained in our various borrowing agreements, it may adversely affect our liquidity, results of operations and financial condition.

Debt. We have and will continue to have a substantial amount of debt and other obligations. As of June 30, 2004, we had $10.3 billion of total debt ($4.3 billion of which is secured by finance receivables) and $1.8 billion of liabilities to trusts issuing preferred securities. Cash and cash equivalents were $2.5 billion at June 30, 2004. Our substantial debt and other obligations could have important consequences. For example, it could (i) increase our vulnerability to general adverse economic and industry conditions; (ii) limit our ability to obtain additional financing for future working capital, capital expenditures, acquisitions and other general corporate requirements; (iii) increase our vulnerability to interest rate fluctuations because a portion of our debt has variable rates; (iv) require us to dedicate a substantial portion of our cash flows from operations to service debt and other obligations thereby reducing the availability of our cash flows from operations for other purposes; (v) limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; (vi) place us at a competitive disadvantage compared to our competitors that have less debt; and (vii) become due and payable upon a change in control. If new debt is added to our current debt levels, these related risks could increase.

Liquidity. Our liquidity is a function of our ability to successfully generate cash flow from an appropriate combination of efficient operations and improvements therein, financing from third parties, access to capital markets and securitizations of our finance receivables portfolios. With $2.5 billion of cash and cash equivalents on hand at June 30, 2004 and borrowing capacity under our 2003 Credit Facility of $700 million, less $15.0 million utilized for letters of credit, we believe our liquidity (including operating and other cash flows that we expect to generate) will be sufficient to meet operating requirements as they occur and to satisfy all scheduled debt maturities for at least the next twelve months; however, our ability to maintain sufficient liquidity going forward depends on our ability to generate cash from operations and access to the financial markets, both or which are subject to general economic, financial, competitive, legislative, regulatory and other market factors that are beyond our control.

The 2003 Credit Facility contains affirmative and negative covenants including limitations on: issuance of debt and preferred stock; investments and acquisitions; mergers; certain transactions with affiliates; creation of liens; asset transfers; hedging transactions; payment of dividends and certain other payments and intercompany loans. The 2003 Credit Facility contains financial maintenance covenants, including minimum EBITDA, as defined, maximum leverage (total adjusted debt divided by EBITDA), annual maximum capital expenditures limits and minimum consolidated net worth, as defined. The indentures governing our outstanding senior notes contain similar covenants. They do not, however, contain any financial maintenance covenants, except the fixed charge coverage ratio applicable to certain types of payments. Our U.S. Loan Agreement with GE (effective through 2010) relating to our vendor financing program (the Loan Agreement) provides for a series of monthly secured loans up to $5.0 billion outstanding at any time. As of June 30, 2004, $2.6 billion was outstanding under this Loan Agreement. The Loan Agreement, as well as similar loan agreements with GE in the U.K. and Canada, incorporates the financial maintenance covenants contained in the 2003 Credit Facility and contains other affirmative and negative covenants.

At June 30, 2004, we were in full compliance with the covenants and other provisions of the 2003 Credit Facility, the senior notes and the Loan Agreement and expect to remain in full compliance for at least the next twelve months. Any failure to be in compliance with any material provision or covenant of the 2003 Credit Facility or the senior notes could have a material adverse effect on our liquidity, results of operations and financial condition. Failure to be in compliance with the covenants in the Loan Agreement, including the financial maintenance covenants incorporated from the 2003 Credit Facility, would result in an event of termination under the Loan Agreement and in such case GE would not be required to make further loans to us. If GE were to make no further loans to us, and assuming a similar facility was not established, it would materially adversely affect our liquidity and out ability to fund our customers purchases of our equipment and this could materially adversely affect our results of operations.

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Our business, results of operations and financial condition may be negatively impacted by legal and regulatory matters.

We have various contingent liabilities that are not reflected on our balance sheet, including those arising as a result of being involved in a variety of claims, lawsuits, investigations and proceedings concerning securities law, intellectual property law, environmental law, employment law and ERISA, as discussed in Note 10 to our Consolidated Financial Statements included in our Quarterly Report on Form 10-Q for the three months ended June 30, 2004, which is incorporated by reference herein. We determine whether an estimated loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. We assess potential liability by analyzing our litigation and regulatory matters using available information. We develop our views on estimated losses in consultation with outside counsel handling our defense in these matters, which involves an analysis of potential results, assuming a combination of litigation and settlement strategies. Should developments in any of our other legal matters cause a change in our determination as to an unfavorable outcome and result in the need to recognize a material accrual, or should any of these matters result in a final adverse judgment or be settled for significant amounts, they could have a material adverse effect on our results of operations, cash flows and financial position in the period or periods in which such change in determination, judgment or settlement occurs.

USE OF PROCEEDS

The net proceeds to be received by us from the sale of the Notes after deducting the underwriting discounts and commissions and estimated offering expenses payable by us, are approximately $492 million. We intend to use such net proceeds for general corporate purposes.

CAPITALIZATION

The following table sets forth our unaudited consolidated cash and cash equivalents and capitalization as of June 30, 2004, and as adjusted to give effect to this offering. The financial information identified as Actual was derived from our condensed consolidated financial statements as of such date. The As Adjusted data presented below gives effect to this offering as if it were consummated on June 30, 2004. You should read the information in this table together with our consolidated financial statements and related notes thereto, incorporated by reference in this prospectus supplement and the accompanying prospectus.

	As of June 30, 2004	
	Actual	As Adjusted
	(Dollars in Millions)	
Cash and cash equivalents	$ 2,542	$ 3,034
Debt maturing within one year(1)	$ 4,219	$ 4,219
Long-term debt(2)	6,051	6,051
Senior Notes due 2011		500
Total debt	10,270	10,770
Liabilities to subsidiary trusts issuing preferred securities(3)	1,751	1,751
Common shareholder s equity and preferred stock:		
Series C mandatory convertible preferred stock	889	889
Common stock, par value $1.00 per share, 1.05 billion shares authorized 839,106,777 shares issued and outstanding	840	840
Additional paid-in capital	2,961	2,961
Retained earnings	1,726	1,726
Accumulated other comprehensive loss	(1,336)	(1,336)
Total common shareholders equity and preferred stock	5,080	5,080
Total capitalization	$ 17,101	$ 17,601

(1) As of June 30, 2004, we had approximately $2.3 billion of debt obligations ($1.1 billion of which is debt secured by finance receivables) expected to be repaid during the remainder of 2004 and another $1.9 billion ($900 million of which is debt secured by finance receivables) maturing in the first six months of 2005.

(2) For additional information with respect to our long-term debt and other obligations, see page S-51.

(3) For additional information with respect to our liabilities to subsidiary trusts issuing preferred securities, see page S-55. The $1,751 million reflects a $1,067 million liability to Xerox Capital Trust II (Trust II), which includes a put option dated December 2004. The put option corresponds to an identical December 2004 put option held by investors of the Trust Preferred Securities, which were issued by Trust II in 2001. Our liability to the trust is classified as long-term in our financial statements as we have the intent and ability to convert the obligations to equity through the issuance of common shares if put to us in 2004.

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DESCRIPTION OF THE NOTES

The Company will issue $500,000,000 aggregate principal amount of Senior Notes due 2011 (the Notes) pursuant to a supplemental indenture to be dated as of August 10, 2004 (the Supplemental Indenture) to an indenture dated as of June 25, 2003 (the Indenture), between itself and Wells Fargo Bank, National Association (as successor by merger to Wells Fargo Bank Minnesota, National Association), as Trustee (the Trustee). References to the Indenture in this Description of the Notes include the Supplemental Indenture. The following is a summary of the material provisions of the Indenture. It does not include all of the provisions of the Indenture. We urge you to read the Indenture because it defines your rights. The terms ofom">

Net (decrease) increase in unrealized appreciation of investments

(84,964
)

53,308

(123,791
)

109,315

Net realized and unrealized gain on investments

26,265

53,308

18,118

109,370

Increase in net assets from operations

$
30,694

$
59,568

$
19,825

$
113,237

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(Unaudited)
(In thousands)

	Nine Months Ended December 31, 2014	Nine Months Ended December 31, 2013
Operations:		
Net investment income	$1,707	$3,867
Net realized gain on investments	141,909	55
Net (decrease)increase in unrealized appreciation of investments	(123,791)	109,315
Increase in net assets from operations	19,825	113,237
Distributions from:		
Net investment income	(3,083)	(3,050)
Taxes incurred on deemed capital gain distributions	(54,370)	(3,787)
Capital share transactions:		
Exercise of employee stock options	163	1,327
Stock option expense	287	347
(Decrease) increase in net assets	(37,178)	108,074
Net assets, beginning of period	770,388	659,777
Net assets, end of period	$733,210	$767,851

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Cash flows from operating activities				
Increase in net assets from operations	$30,694	$59,568	$19,825	$113,237
Adjustments to reconcile increase (decrease) in net assets from operations to net cash provided by (used in) operating activities:				
Net proceeds from disposition of investments	117,028	–	170,433	55
Return of capital on investments	89	–	165	–
Purchases of securities	(449)	(679)	(525)	(10,501)
Depreciation and amortization	21	5	29	16
Net pension (benefit) expense	(120)	44	(410)	132
Realized gain on investments before income tax	(111,229)	–	(141,909)	(55)
Taxes incurred on deemed capital gain distribution	(54,370)	(3,787)	(54,370)	(3,787)
Net decrease (increase)in unrealized appreciation of investments	84,964	(53,308)	123,791	(109,315)
Stock option expense	95	(2)	287	347
Increase in dividend and interest receivable	(7,096)	(7,881)	(6,587)	(7,901)
(Increase) decrease in receivables from affiliates	14,024	(136)	(303)	(365)
(Increase) decrease in income tax receivable	231	–	(97)	–
(Increase) decrease in other assets	(386)	(13)	(589)	31
Increase in taxes payable	54,370	4,110	54,370	4,110
Increase in other liabilities	279	1,295	13	724
Increase (decrease) in deferred income taxes	(180)	(1,024)	70	(1,055)
Net cash provided by (used in) operating activities	127,965	(1,808)	164,193	(14,327)
Cash flows from financing activities				
Distributions from undistributed net investment income	(1,541)	(1,525)	(3,083)	(3,050)
Proceeds from exercise of employee stock options	62	868	163	1,327
Net cash used in financing activities	(1,479)	(657)	(2,920)	(1,723)
Net increase (decrease) in cash and cash equivalents	126,486	(2,465)	161,273	(16,050)
Cash and cash equivalents at beginning of period	122,950	68,182	88,163	81,767
Cash and cash equivalents at end of period	$249,436	$65,717	$249,436	$65,717

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS
(Unaudited)
December 31, 2014

Company	Equity (a)	Investment (b)	Cost	Value (c)
ATLANTIC CAPITAL BANCSHARES, INC Atlanta, Georgia Holding company of Atlantic Capital Bank, a full service commercial bank.	1.9%	300,000 shares of common stock (acquired 4-10-07)	$ 3,000,000	$ 4,388,000
¥BALCO, INC. Wichita, Kansas Specialty architectural products used in the construction and remodeling of commercial and institutional buildings.	95.7%	445,000 shares of common stock and 60,920 shares Class B non-voting common stock (acquired 10-25-83 and 5-30-02)	624,920	4,500,000
*BOXX TECHNOLOGIES, INC. Austin, Texas Workstations for computer graphic imaging and design.	14.9%	3,125,354 shares of Series B Convertible Preferred Stock, convertible into 3,125,354 shares of common stock at $0.50 per share (acquired 8-20-99 thru 8-8-01)	1,500,000	2,366,000
¥ CAPSTAR HOLDINGS CORPORATION Dallas, Texas Acquire, hold and manage real estate for potential development and sale.	100%	500 shares of common stock (acquired 6-10-10) and 1,000,000 shares of preferred stock (acquired 12-17-12)	4,703,619	7,426,000
DEEPWATER CORROSION SERVICES, INC. Houston, Texas full-service corrosion control company providing the oil and gas industry with expertise in cathodic protection and asset integrity management.	31.1%	127,004 shares of Series A convertible preferred stock, convertible into 127,004 shares of common stock at $1.00 per shares (acquired 4-9-13)	8,000,000	6,856,000
iMEMORIES, INC. Scottsdale, Arizona Enables online video and photo sharing and DVD creation for home movies recorded in analog and new digital format.	23.3%	17,391,304 shares of 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	–
		4,684,967 shares of 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	–
		Warrants to purchase 2,500,000 shares of common stock at $0.12 per share, expiring 1-21-21(acquired 9-13-10 thru 1-21-11)	–	–
		10% convertible notes, $308,000 principal due 7-31-14 (acquired 9-7-12)	308,000	18,000
		10% convertible notes, $880,000 principal due 7-31-14 (acquired 3-15-13)	880,000	52,000
			148,507	148,507

18% notes, $148,507 principal due 7-31-15 (acquired 11-3-14)		
	6,414,986	218,507

¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note (b)

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS
(Unaudited)
December 31, 2014

Company	Equity (a)	Investment (b)	Cost	Value (c)
INSTAWARES HOLDING COMPANY, LLC Atlanta, Georgia Provides services to the restaurant industry via its five subsidiary companies.	4.2%	3,846,154 Class D Convertible Preferred Stock (acquired 5-20-11)	5,000,000	475,000
KBI BIOPHARMA, INC. Durham, North Carolina Provides fully-integrated, outsourced drug development and bio-manufacturing services.	15.7%	10,298,592 shares of Series B-2 Convertible Preferred Stock, convertible into 10,298,592 shares of common stock at $0.49 per share (acquired 9-08-09)	5,000,000	11,500,000
		Warrants to purchase 94,510 shares of Series B preferred stock at $ 0.70 per share, acquired 1-26-12	-	-
			5,000,000	11,500,000
¥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 of Series A Convertible Preferred Stock, convertible into 800,000 shares of common stock at $1.00 per share (acquired 11-4-97)	800,000	4,000,000
		4,000,002 shares of common stock (acquired 11-4-97)	4,615,000	20,000,000
			5,415,000	24,000,000
¥THE RECTORSEAL CORPORATION Houston, Texas Specialty chemicals for plumbing, HVAC, electrical, construction, industrial, oil field and automotive applications; smoke containment systems for building fires; also owns 20% of The Whitmore Manufacturing Company.	100.0%	27,907 shares of common stock (acquired 1-5-73 and 3-31-73)	52,600	335,300,000
TITANLINER, INC. Midland, Texas Manufactures, installs and rents spill containment system for oilfield applications.	31.2%	217,038 shares of Series A Convertible Preferred Stock convertible into 217,038 shares of Series A Preferred Stock at $14.76 per share (acquired 6-29-12)	3,203,000	3,799,000
		7% senior subordinated secured promissory note, due 6-30-17 (acquired 6-29-12)	2,747,000	2,747,000
		Warrants to purchase 122,239 shares of Series A Preferred Stock at $ 0.01 per share,	-	2,140,000

expiring 12-31-22		
	5,950,000	8,686,000

¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note (b)

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS
(Unaudited)
December 31, 2014

Company	Equity (a)	Investment (b)	Cost	Value (c)
TRAX HOLDINGS, INC. Scottsdale, Arizona Provides a comprehensive set of solutions to improve the transportation validation, accounting, payment and information management process.	28.7%	475,430 shares of Series B convertible Preferred Stock convertible into 475,430 shares of common stock at $8.41 per share(acquired 12-5-12)	4,000,000	7,200,000
		1,061,279 shares of Series A Convertible Preferred Stock, convertible into 1,061,279 shares of common stock at $4.71 per share (acquired 12-8-08 and 2-17-09)	5,000,000	12,300,000
			9,000,000	19,500,000
*WELLOGIX, INC. Houston, Texas Developer and supporter of software used by the oil and gas industry.	18.9%	4,788,371 shares of Series A-1 Convertible Participating Preferred Stock, convertible into 4,788,371 shares of common stock at $1.04 per share (acquired 8-19-05 thru 6-15-08)	5,000,000	4,505,000
¥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 of common stock (acquired 8-31-79)	1,600,000	87,600,000
MISCELLANEOUS	–	Alamo Group Inc. ‡1,676 shares of common stock	-	81,185
	–	Ballast Point Ventures II, L.P. 2.2% limited partnership interest (acquired 8-4-08 thru 11-6-14)	2,634,790	3,564,000
	–	BankCap Partners Fund I, L.P. 5.5% limited partnership interest (acquired 7-14-06 thru 11-16-12)	5,071,514	4,375,000
	–	CapitalSouth Partners Fund III, L.P. 1.9% limited partnership interest (acquired 1-22-08 and 11-16-11)	433,403	231,999
	–	Diamond State Ventures, L.P. 1.4% limited partnership interest (acquired 10-12-99 thru 8-26-05)	-	16,000
	–	First Capital Group of Texas III, L.P. 3.0% limited partnership interest (acquired 12-26-00 thru 8-12-05)	778,895	108,000
	100%	¥ Humac Company	–	250,000

		1,041,000 shares of common stock (acquired 1-31-75 and 12-31-75)		
	–	STARTech Seed Fund II 3.2% limited partnership interest (acquired 4-28-00 thru 2-23-05)	622,783	18,000
TOTAL INVESTMENTS			$ 70,802,510	$ 525,964,691

¥ Control investment * Affiliated investment ‡Unrestricted securities as defined in Note (b)

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2014

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 and snow removal equipment for municipalities.	22.0%	‡2,831,300 shares of common stock (acquired 4-1-73 thru 5-09-13)	$ 2,190,937	$ 153,824,529
ATLANTIC CAPITAL BANCSHARES, INC Atlanta, Georgia Holding company of Atlantic Capital Bank, a full service commercial bank.	1.9%	300,000 shares of common stock (acquired 4-10-07)	3,000,000	3,817,000
¥BALCO, INC. Wichita, Kansas Specialty architectural products used in the construction and remodeling of commercial and institutional buildings.	95.7%	445,000 shares of common stock and 60,920 shares Class B non-voting common stock (acquired 10-25-83 and 5-30-02)	624,920	4,500,000
*BOXX TECHNOLOGIES, INC. Austin, Texas Workstations for computer graphic imaging and design.	14.9%	3,125,354 shares of 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	1,040,000
¥ CAPSTAR HOLDINGS CORPORATION Dallas, Texas Acquires holds and manages real estate for potential development and sale.	100%	500 shares of common stock (acquired 6-10-10) and 1,000,000 shares of preferred stock (acquired 12-17-12)	4,703,619	7,514,000
CINATRA CLEAN TECHNOLOGIES, INC. Houston, Texas Cleans above ground oil storage tanks with a patented, automated system.	76.2%	12% subordinated secured promissory note, due 5-9-16 (acquired 5-19-10 thru 10-20-10)	779,278	1
		12% subordinated secured promissory note, due 5-9-17 (acquired 5-9-11 thru 10-26-11)	2,285,700	1
		12% subordinated secured promissory note, due 3-31-17 (acquired 9-9-11 and 10-26-11)	1,523,800	1
		10% subordinated secured promissory note, due 5-9-17 (acquired 7-14-08 thru 4-28-10)	921,588	1
		12% subordinated secured promissory note, due 10-31-17 (acquired 10-19-12)	499,997	1
		12% subordinated secured promissory note, due 9-30-14 (acquired 7-25-13)	1,157,850	1
			152,394	1

12% subordinated secured promissory note, due 9-30-14 (acquired 2-19-14)		
9,891,578 shares of Series A Convertible Preferred Stock, convertible into 9,891,578 shares of common stock at $1.00 per share (acquired 7-14-08 thru 3-15-14)	9,891,578	1
Warrants to purchase 1,436,499 shares of common stock at $1.00 per share, expiring 10-31-2027 (acquired 5-9-11 thru 10-19-12)	–	–
	17,212,185	8

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

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2014

Company	Equity (a)	Investment (b)	Cost	Value (c)
DEEPWATER CORROSION SERVICES, INC. Houston, Texas Full-service corrosion control company providing the oil and gas industry with expertise in cathodic protection and asset integrity management.	31.3%	127,004 shares of Series A convertible preferred stock, convertible into 127,004 shares of common stock at $1.00 per shares (acquired 4-9-13)	8,000,000	8,000,000
¥DISCOVERY ALLIANCE, LLC Dallas, Texas Provides services related to intellectual property protection and development.	90%	90.0% limited liability company interest (acquired 9-12-08 thru 10-15-12)	1,315,000	400,000
*†ENCORE WIRE CORPORATION McKinney, Texas Electric wire and cable for residential, commercial and industrial construction use.	6.2%	‡1,312,500 shares of common stock (acquired 9-10-92 thru 10-15-98)	5,200,000	63,590,625
iMEMORIES, INC. Scottsdale, Arizona Enables online video and photo sharing and DVD creation for home movies and photos recorded in analog and digital formats.	23.3%	17,391,304 shares of 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	2
		4,684,967 shares of 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	994,000
		Warrants to purchase 8,396,000 shares of common stock at $0.12 per share, expiring 7-31-14 (acquired 9-13-10 thru 3-15-13)	–	–
		10% convertible notes, $308,000 principal due 7-31-14 (acquired 9-7-12)	308,000	308,000
		10% convertible notes, $880,000 principal due 7-31-14 (acquired from 3-15-13 to 9-26-13)	880,000	880,000
			6,266,479	2,182,002

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

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2014

Company	Equity (a)	Investment (b)	Cost	Value (c)
INSTAWARES HOLDING COMPANY, LLC Atlanta, Georgia Provides services and distributes equipment and supplies to the restaurant industry via its five subsidiary companies.	4.3%	3,846,154 Class D Convertible Preferred Stock (acquired 5-20-11)	5,000,000	3,354,000
KBI BIOPHARMA, INC. Durham, North Carolina Provides fully-integrated, outsourced drug development and bio-manufacturing services.	17.1%	10,204,082 shares of Series B-2 Convertible Preferred Stock, convertible into 10,204,802 shares of common stock at $0.49 per share (acquired 9-08-09)	5,000,000	7,000,000
		Warrants to purchase 94,510 shares of Series B preferred stock at $ 0.70 per share, acquired 1-26-12	-	-
			5,000,000	7,000,000
¥MEDIA RECOVERY, INC. Dallas, Texas Distributor of computer datacenter and office automation supplies and accessories; manufactures and distributes devices used to monitor and manage intransit inventory and dunnage products for protecting shipments.	97.9%	800,000 shares of Series A Convertible Preferred Stock, convertible into 800,000 shares of common stock at $1.00 per share (acquired 11-4-97)	800,000	4,000,000
		4,000,002 shares of common stock (acquired 11-4-97)	4,615,000	19,900,000
			5,415,000	23,900,000
¥THE RECTORSEAL CORPORATION Houston, Texas Specialty chemicals, tools and products for plumbing, HVAC, electrical, construction, industrial, and oil field; smoke containment systems for building fires; also owns 20% of The Whitmore Manufacturing Company.	100.0%	27,907 shares of common stock (acquired 1-5-73 and 3-31-73)	52,600	275,800,000
TITANLINER, INC. Midland, Texas Manufactures, installs and rents spill containment system for oilfield applications.	31.2%	217,038 shares of Series A Convertible Preferred Stock convertible into 217,038 shares of Series A Preferred Stock at $14.76 per share (acquired 6-29-12)	3,203,000	1
		7% senior subordinated secured promissory note, due 6-30-17 (acquired 6-29-12)	2,747,000	1,519,000
		Warrants to purchase 122,239 shares of Series A Preferred Stock at $ 0.01 per share,	-	-

expiring 12-31-22			
		5,950,000	1,519,001

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

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2014

Company	Equity (a)	Investment (b)	Cost	Value (c)
TRAX HOLDINGS, INC. Scottsdale, Arizona Provides a comprehensive set of solutions to improve the validation, accounting and payment of transportation-related invoices.	28.4%	475,430 shares of Series B convertible Preferred Stock convertible into 475,430 shares of common stock at $8.41 per share(acquired 12-5-12)	4,000,000	7,700,000
		1,061,279 shares of Series A Convertible Preferred Stock, convertible into 1,061,279 shares of common stock at $4.71 per share (acquired 12-8-08 and 2-17-09)	5,000,000	13,300,000
			9,000,000	21,000,000
*WELLOGIX, INC. Houston, Texas Formerly a developer and supporter of business process software used by the oil and gas industry.	19.0%	4,788,371 shares of Series A-1 Convertible Participating Preferred Stock, convertible into 4,788,371 shares of common stock at $1.04 per share (acquired 8-19-05 thru 6-15-08)	5,000,000	25,000
¥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 of common stock (acquired 8-31-79)	1,600,000	88,500,000
MISCELLANEOUS	–	Ballast Point Ventures II, L.P. 2.2% limited partnership interest (acquired 8-4-08 thru 2-15-13)	2,334,790	3,167,000
	–	BankCap Partners Fund I, L.P. 5.5% limited partnership interest (acquired 7-14-06 thru 11-16-12)	6,000,000	5,385,000
	–	‡Capitala Finance Corporation 108,105 shares of common stock (acquired 9-25-13)	1,363,799	2,083,183
	–	CapitalSouth Partners Fund III, L.P. 1.9% limited partnership interest (acquired 1-22-08 and 11-16-11)	467,457	237,000
	–	Diamond State Ventures, L.P. 1.4% limited partnership interest (acquired 10-12-99 thru 8-26-05)	-	16,000

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

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2014

Company	Equity (a)	Investment (b)	Cost	Value (c)
	–	First Capital Group of Texas III, L.P. 3.0% limited partnership interest (acquired 12-26-00 thru 8-12-05)	778,895	117,000
	100%	¥Humac Company 1,041,000 shares of common stock (acquired 1-31-75 and 12-31-75)	–	210,000
	–	†North American Energy Partners, Inc. 77,194 shares of common stock (acquired 8-20-12)	236,986	555,797
	–	STARTech Seed Fund II 3.2% limited partnership interest (acquired 4-28-00 thru 2-23-05)	754,327	183,000
TOTAL INVESTMENTS			$ 98,966,994	$ 677,920,145

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

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

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Notes to Consolidated Schedule of Investments

a) Equity

The percentages in the “Equity” column express equity interests held in each issuer collectively by each of Capital Southwest Corporation and its wholly-owned subsidiary, Capital Southwest Venture Corporation (together with Capital Southwest Corporation, the “Company”). Each percentage represents the amount of the issuer’s common stock owned by the Company or which the Company has the right to acquire as a percentage of the issuer’s total outstanding common stock, on a fully diluted basis.

(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 December 31, 2014 and March 31, 2014, restricted securities represented approximately 100% and 67.5%, respectively, of the value of the consolidated investment portfolio.

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”) 820, Fair Value Measurements and Disclosures. In accordance with the 1940 Act, unrestricted publicly traded securities, for which the market quotations are readily available, are valued at the closing sale price for the NYSE listed securities on the valuation date. Privately held securities are valued as determined in good faith by the board of directors.

ASC 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 and excludes transaction costs. Under ASC 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 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 on the valuation date. Privately held securities are valued as determined in good faith by the board of directors. The board of directors considers the financial condition and operating results of the issuer; the long-term potential of the business of the issuer; the market for and recent sales prices of the issuer’s securities; the values of similar securities issued by companies in similar businesses; 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.

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

(d) 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.

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Notes to Consolidated Financial Statements

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

Capital Southwest Corporation ("CSWC") is a publicly traded investment company. Our investment interests are focused on acquisitions and investments in a broad range of industry segments. We were organized as a Texas corporation on April 19, 1961. Until September 1969, CSWC 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, as amended (the "1940 Act"). Prior to March 30, 1988, CSWC was registered as a closed-end, non-diversified investment company under the 1940 Act. On that date, CSWC 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 CSWC wholly owns CSVC, the portfolios of both CSWC and CSVC are referred to collectively as "our," "we" and "us." Capital Southwest Management Company ("CSMC"), a wholly-owned subsidiary of CSWC, is the management company for CSWC 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 primarily consists of private companies in which we have controlling interests and private companies in which we have minority interests. 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 controlled portfolio companies.

On December 2, 2014, CSWC announced that its board of directors had unanimously approved a plan to spin off certain of its controlled assets into a standalone publicly traded industrial growth company through a distribution to our shareholders of all of the shares of common stock of the new spin-off company ("Industrial Co.") that would hold, directly or indirectly, the controlled assets. CSWC anticipates that the Industrial Co. will be structured as a C corporation for tax purposes and operate as a diversified industrial growth company initially across two core industries: specialty chemicals and industrial products. Industrial Co. will focus on generating free cash flow by growing organically and through complementary and synergistic acquisitions. Joseph B. Armes, chairman and chief executive officer of CSWC, will continue to serve as chairman of CSWC and is expected to become chairman and chief executive officer of Industrial Co. after the spin-off is completed.

Following the spin-off, CSWC anticipates that it will maintain operations as an internally-managed BDC and pursue a credit-focused investing strategy akin to similarly structured organizations. The business will continue to provide capital to middle-market companies. CSWC intends to primarily invest in debt securities, including senior "unitranche" debt, second lien and subordinated debt, and may also invest in preferred stock and common stock alongside its debt investments or through warrants.

CSWC will remain a regulated investment company ("RIC") under Subchapter M of the U.S. Internal Revenue Code of 1986. See Note 4 below for a discussion of CSWC's status as an RIC. CSWC's chief investment officer, Bowen S. Diehl, is expected to become chief executive officer of CSWC after the spin-off is completed.

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The spin-off is expected to be tax-free to shareholders and consummated by the end of the third quarter of 2015, however there can be no assurances regarding the ultimate timing of the transaction or that the transaction will be completed. The spin-off will be contingent upon various conditions, including the approval of our shareholders, the receipt of an order of exemptive relief from the Securities and Exchange Commission, the effectiveness of a Form 10 registration statement filed with the Securities and Exchange Commission, receipt of a favorable opinion and/or ruling with respect to the tax-free nature of the transaction for federal income tax purposes, final approvals of the board of directors and other customary conditions. On December 2, 2014, CSWC filed a request for exemptive relief with the Securities and Exchange Commission. As of the date of this filing, CSWC has not received a response to this request. In addition, as of the date of this filing, CSWC has not filed a Form 10 registration statement with the Securities and Exchange Commission.

Basis of Presentation

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles 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, and all intercompany transactions have been eliminated.

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."

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies followed in the preparation of the consolidated financial statements of CSWC.

Fair Value Measurements. 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. This statement 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 Statement 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 Statement 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.

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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 annually retains a nationally recognized firm to provide limited scope third party valuation services on certain portfolio investments. Our board of directors retained Duff & Phelps to provide limited scope third party valuation services on three investments comprising 57.3% of our net asset value at March 31, 2014.

We believe our investments at December 31, 2014 and March 31, 2014 approximate fair value as of those dates based on the markets in which we operate and other conditions in existence at those reporting periods.

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.

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 single 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 we do not expect the debtor to be able to service all of its debt or other obligations, we will generally establish a reserve against interest income, thereby placing the loan or debt security's status on a 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. CSWC and CSVC have elected and intend to comply with the requirements of the Internal Revenue Code ("IRC") necessary to qualify as regulated investment companies, or 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 company taxable income, as defined by the IRC, each year. Investment company taxable income generally differs from net income for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses. Investment company taxable income generally excludes net unrealized appreciation or depreciation, as investment gains and losses are not included in investment company taxable income until they are realized.

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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. During the nine months ended December 31, 2014, we did not distribute any capital gain dividends 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 CSWC, is not a RIC and is required to pay taxes at the current corporate rate of 35%.

We account for interest and penalties as part of operating expenses. There were no interest or penalties incurred during the three and nine months ended December 31, 2014 and 2013.

Deferred Taxes. CSMC sponsors a qualified defined benefit pension plan which covers its employees and employees of certain wholly-owned portfolio companies. In addition, CSMC records phantom stock options and bonus accruals on a quarterly basis. Deferred taxes related to the qualified defined pension plan, phantom stock options and bonus accruals 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 payment awards granted to employees. 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. For phantom stock options, the option value of phantom stock awards is calculated based on our net asset value. We value the plan each quarter and either increase or decrease the liability based on the phantom option value. See Note 6 for further discussion.

Retirement Plans. We record annual amounts relating to the pension plans based on calculations and various actuarial assumptions. Material changes in pension costs could occur due to changes in the discount rate, the expected long-term rate of return, mortality tables, and the level of contributions to the plans and other factors. The funded status of the qualified plan is the difference between the fair value of plan assets and the benefit obligation. We recognize changes in the funded status of the qualified plan in the Statement of Assets and Liabilities in the year in which the changes occur and measure its assets and obligations as of the date of the employer's fiscal year-end. In addition, CSWC also sponsors an unfunded Retirement Restoration Plan, which is a nonqualified plan that provides for the payment, upon retirement, of the difference between the maximum annual payment permissible under the qualified retirement plan pursuant to Federal limitations and the amount which would otherwise have been payable under the qualified plan. We presently use March 31 as the measurement date for retirement plans.

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Concentration of Risk. We place our uninvested cash in financial institutions, and such balances may be in excess of the federally insured limits.

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.

The levels of fair value inputs used to measure our investments are characterized in accordance with the fair value hierarchy established by 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 unrestricted securities. Such investments are valued at the closing price for NYSE listed 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 December 31, 2014 and March 31, 2014.

- 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 used Level 3 inputs for measuring the fair value of approximately 100% and 67.5% of our investments as of December 31, 2014 and March 31, 2014, respectively. See "Notes to Consolidated Schedule of Investments" (c) on page 16 for the investment policy used to determine the fair value of these investments.

As required by 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.

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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;
- 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 costs 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 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 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. A 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.

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Limited Partnership or Limited Liability Company Interests

For recent investments, we generally 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 substantive evidence that the net asset value does not correspond to fair value. All investments of each fund are valued by each fund in accordance with ASC 820.

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 as of December 31, 2014 and March 31, 2014. 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 at 12/31/2014 (in millions)	Unobservable Input	Range	Weighted Average
Preferred & Common Equity	Market Approach	$ 476.4	EBITDA Multiple	0.37x – 7.75 x	7.07 x
	Market Approach	19.5	Revenue Multiple	2.50 x	2.50 x
	Market Approach	11.9	Cash and Asset Value	NA	NA
	Market Approach	4.4	Multiple of Tangible Book Value	1.70 x	1.70 x
	Market Approach	0.3	Market Value of Held Securities	NA	NA
		512.5			
Warrants	Black Scholes Pricing Model	2.1	Stock Price	$0.00-$17.51	$17.51
Debt	Market Approach	2.8	Face Value	NA	NA
	Liquidation Value	0.2	Cash and Asset Value	NA	NA
		3.0			
Partnership Interests	Net Asset Value	8.3	Fund Value	NA	NA
	Total	$ 525.9			

Type	Valuation Technique	Fair Value at 3/31/2014 (in millions)	Unobservable Input	Range	Weighted Average
Preferred & Common Equity	Market Approach	$ 404.1	EBITDA Multiple	3.50x – 7.78 x	7.00 x
	Market Approach	22.0	Revenue Multiple	1.53x – 2.50 x	2.46 x
	Market Approach	8.0	Recent Transaction Price	NA	NA
	Market Approach	7.6	Cash and Asset Value	NA	NA
	Market Approach	3.8	Multiple of Tangible Book Value	1.54 x	1.54 x

	Market Approach	0.2	Market Value of Held Securities	NA		NA	
		445.7					
Debt	Discounted Cash Flow	1.5	Discount Rate	11.69	%	11.69	%
	Recent Transaction Price	1.2	Recent Transaction Price	NA		NA	
Partnership Interests		2.7					
	Net Asset Value	9.5	Fund Value	NA		NA	
	Total	$ 457.9					

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The following fair value hierarchy tables set forth our investment portfolio by level as of December 31, 2014 and March 31, 2014 (in millions):

		Fair Value Measurements at December 31, 2014 Using		
Asset Category	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt	$3.0	$–	$ –	$ 3.0
Partnership Interests	8.3	–	–	8.3
Preferred Equity	54.6	–	–	54.6
Common Equity	458.0	0.1	–	457.9
Warrants	2.1	–	–	2.1
Total Investments	$526.0	$0.1	$ –	$ 525.9

		Fair Value Measurements at March 31, 2014 Using		
Asset Category	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt	$2.7	$–	$ –	$ 2.7
Partnership Interests	9.5	–	–	9.5
Preferred Equity	47.0	–	–	47.0
Common Equity	618.7	220.0	–	398.7
Total Investments	$677.9	$220.0	$ –	$ 457.9

The following table provides a summary of changes in the fair value of investments measured using Level 3 inputs during the nine months ended December 31, 2014 (in millions):

	Fair Value 3/31/14	Net Unrealized Appreciation (Depreciation)	New Investments	Divestitures	Distributions	Fair Value at 12/31/2014
Debt	$2.7	$ 0.1	$ 0.2	$ –	$ –	$ 3.0
Partnership Interests	9.5	–	0.3	(1.4)	(0.1)	8.3
Warrants	–	2.1	–	–	–	2.1

Preferred Equity	47.0	7.6	–	–	–	54.6
Common Equity	398.7	59.2	–	–	–	457.9
Total Investments	$ 457.9	$ 69.0	$ 0.5	$ (1.4)	$ (0.1)	$ 525.9

4. INCOME TAXES

We operate to qualify as a RIC under Subchapter M of the IRC and have a tax year end of December 31. In order to qualify as a RIC, we must annually distribute at least 90% of our investment company taxable income, as defined by the IRC, to our shareholders in a timely manner. Investment company income generally 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 is 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.

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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 years ended December 31, 2014 and 2013, we declared and paid ordinary dividends in the amounts of $3,082,911 and $3,049,614, respectively.

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, 2014 and 2013, 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, 2014 and 2013.

A RIC may elect to retain its long-term capital gains by designating them as a "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 nine months ended December 31, 2014, we had long-term capital gains of $141,909,237 for book purposes. For the twelve months ended December 31, 2014, we had long-term capital gains of $155,342,875 for tax purposes, which we elected to retain and treat as deemed distributions to our shareholders.

During our tax year ended December 31, 2013, we sold 9,317,310 shares of common stock of Heelys, Inc. to Sequential Brands Group, Inc. and generated cash proceeds of $20,963,948 and a capital gain of $20,861,458. Subsequently, we distributed and paid $0.69 per share or $10,474,932 of Heely's gain to our shareholders on March 28, 2013. For the nine months ended December 31, 2013, we had net long-term capital gains of $10,491,526 for book purposes. For the twelve months ended December 31, 2013, we had net long-term capital gains of $10,819,079 for tax purposes, which we elected to retain and treat as deemed distributions to our shareholders.

In order to make the election to retain capital gains, we incurred federal taxes on behalf of our shareholders in the amount of $54,370,006 for the tax year ended December 31, 2014. For the tax year ended December 31, 2013, we incurred federal taxes on behalf of our shareholders in the amount of $3,786,678.

For the tax years ended December 31, 2014 and 2013, CSWC and CSVC qualified to be taxed as RICs. We intend to meet the applicable qualifications to be taxed as RICs 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.

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CSMC, a wholly-owned subsidiary of CSWC, 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 wholly-owned portfolio companies. In addition, CSMC records phantom stock option and bonus accruals on a quarterly basis. Deferred taxes related to the qualified defined benefit pension plan and phantom stock option and bonus accruals are recorded as incurred. As of December 31, 2014 and March 31, 2014, CSMC has a deferred tax liability of $2,009,273 and $1,940,009, respectively.

5. ACCUMULATED 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.”

We incur federal taxes on behalf of our shareholders as a result of our election to retain long-term capital gains. We had $155,938,324 and $14,029,087 of accumulated long term capital gains, as of December 31, 2014 and March 31, 2014, respectively. In accordance with the RIC rules, we elected to retain our long-term capital gains for the tax year ended December 31, 2014, incur the applicable income taxes of $54,370,006, and designate the after-tax gain as “deemed distributions” to shareholders. “Deemed distributions” are reclassified from accumulated net realized gains into additional paid in capital at the end of December.

6. EXECUTIVE COMPENSATION PLAN

On August 28, 2014, our Board of Directors adopted an executive compensation plan consisting of grants of nonqualified stock options, restricted stock and cash incentive awards to executive officers of the Company. The plan is intended to align the compensation of the Company’s executive officers with the Company’s key strategic objective of increasing the market value of the Company’s shares through a transformative transaction for the benefit of the Company’s shareholders. Under the plan, Joseph B. Armes, Chief Executive Officer, Kelly Tacke, Chief Financial Officer, and Bowen S. Diehl, Chief Investment Officer, will receive an amount equal to six percent of the aggregate appreciation in the Company’s share price from August 28, 2014 (using a base price of $36.16 per share) to the date of the transformative transaction (such transaction, the “Trigger Event,” the transaction date, the “Trigger Event Date” and such payment amount, the “Total Payout Amount”). The value accretion will include the value of any distributions to the Company shareholders, including any capital stock spun-off to the Company shareholders. As to any payout up to $22.5 million, one-third of the payout will be allocated to each such officer, with any payout in excess of $22.5 million to be allocated as follows: Mr. Armes-- 50%, Ms. Tacke--25% and Mr. Diehl--25%. The initial plan component consists of nonqualified options awarded to purchase 259,000 shares of common stock at an exercise price of $36.60 per share. The second plan component consists of awards of 127,000 shares of restricted stock, which have voting rights but do not have cash dividend rights. The final plan component consists of cash incentive payments awarded to each of Mr. Armes, Ms. Tacke and Mr. Diehl in an amount equal to the excess of each awardee’s allocable portion of the Total Payment Amount over the aggregate value as of the Trigger Event Date of the awardee’s restricted common stock and nonqualified option awards under the plan. The awards shall vest and be exercisable as follows: (i) 1/3 on the Trigger Event Date; (ii) 1/3 on the first anniversary of the Trigger Event Date; and (iii) 1/3 on the second anniversary of the Trigger Event Date. Entitlement to such awards is conditioned on the awardee remaining in the employment of the Company or its subsidiaries on the vesting date, or in the event the employment of the awardee is transferred to a Company subsidiary spun-off to the Company’s shareholders, continuing employment by such spun-off subsidiary. The Company, however, reserves the right, in its sole discretion, to terminate the cash incentive award or to reduce the amount payable thereunder at any time prior to the Trigger Event Date.

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7. STOCK BASED COMPENSATION PLANS

Stock Options

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 560,000 shares. All options are granted at or above market price, generally expire up to 10 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 155,000 shares at $19.19 per share were granted on October 19, 2009. Additionally, options to purchase 80,000 shares at $23.95 per share were granted on March 22, 2010, options to purchase 60,000 shares at $22.05 per share were granted on July 19, 2010 and options to purchase 40,000 shares at $24.23 per share were granted on July 18, 2011. Options to purchase 30,000 shares at $37.02 per share, 25,000 shares at $33.52 and 30,000 shares at $34.91 were granted on July 15, 2013, January 20, 2014 and March 17, 2014, respectively.

On August 28, 2014, our Board of Directors amended the 2009 Plan, as permitted pursuant to Section 18 of the 2009 Plan (the "First Amendment to the 2009 Plan"). The First Amendment to the 2009 Plan provides that an award agreement may allow an award to remain outstanding after a spin-off or change in control of one or more wholly-owned subsidiaries of the Company. In addition, on August 28, 2014, options to purchase 259,000 shares at $36.60 per share were granted under the 2009 Plan, as amended. These options will not begin to be exercisable or vest until the occurrence of a Trigger Event as described in Note 6 above. At December 31, 2014, there are options to acquire 372,000 shares of common stock outstanding and options to acquire 4,000 shares of common stock 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 granted under our 1999 Plan and outstanding on July 20, 2009 continue in effect and are governed by the provisions of the 1999 Plan. All options granted under the 1999 Plan were granted at market price on the date of grant, generally expire up to 10 years from the date of grant and are generally exercisable on or after the first anniversary of the date of grant in five to ten annual installments. At December 31, 2014, there are options to acquire 38,000 shares of common stock outstanding under the 1999 Plan.

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. Share-based compensation cost for stock options is measured based on the closing fair market value of our Company's common stock on the date of the grant. Accordingly, for the quarters ended December 31, 2014 and 2013, we recognized stock option compensation expense of $58,623 and $8,044, respectively. For the nine months ended December 31, 2014 and 2013, we recognized stock option compensation expense of $185,834 and $283,341, respectively. We have not recognized any compensation expense related to the 259,000 options granted on August 28, 2014 as these options are subject to a contingent vesting mechanism.

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As of December 31, 2014, the total remaining unrecognized compensation cost related to non-vested stock options was $661,569, which will be amortized over the weighted-average vesting period of approximately 2.4 years.

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

		Black-Scholes Pricing Model Assumptions			
Date of Issuance	Weighted Average Fair Value	Expected Dividend Yield	Risk-Free Interest Rate	Expected Volatility	Expected Life (in years)
2009 Plan*					
July 18, 2011	$ 8.27	0.83%	1.45 %	40.0 %	5
July 19, 2010	$ 7.15	0.91%	1.73 %	37.5 %	5
March 22, 2010	$ 8.14	0.84%	2.43 %	37.8 %	5
October 19, 2009	$ 6.34	1.04%	2.36 %	37.6 %	5
July 15, 2013	$ 11.82	0.54%	1.40 %	36.1 %	5
January 20, 2014	$ 8.37	0.60%	1.64 %	27.0 %	5
March 17, 2014	$ 7.04	0.57%	1.58 %	21.1 %	5
1999 Plan					
July 30, 2008	$ 7.48	0.62%	3.36 %	20.2 %	5
July 21, 2008	$ 6.84	0.67%	3.41 %	20.2 %	5
July 16, 2007	$ 10.44	0.39%	4.95 %	19.9 %	5
July 17, 2006	$ 8.26	0.61%	5.04 %	21.2 %	7
May 15, 2006	$ 7.82	0.64%	5.08 %	21.1 %	7

* Excludes August 28, 2014 grant of options to purchase 259,000 shares of common stock at an exercise price of $36.60 as these options will not begin to be exercisable until the occurrence of a transformative transaction intended to increase the market value of the Company's equity for the benefit of shareholders and cannot be modeled under the Black-Scholes pricing model at this time.

The following table summarizes activity in the 2009 Plan and the 1999 Plan as of December 31, 2014:

	Number of Shares	Weighted Average Exercise Price
<u>2009 Plan</u>		
Balance at March 31, 2012	335,000	$ 21.44
Granted	–	–
Exercised	(108,092)	19.96
Canceled/Forfeited	(56,000)	21.44
Balance at March 31, 2013	170,908	22.37
Granted	85,000	35.25
Exercised	(69,108)	22.27
Canceled/Forfeited	(63,000)	22.08
Balance at March 31, 2014	123,800	31.40
Granted	259,000[1]	36.60
Exercised	(6,800)	23.95
Canceled/Forfeited	(4,000)	23.95
Balance at December 31, 2014	372,000	$ 35.24
<u>1999 Plan</u>		
Balance at March 31, 2012	380,000	28.41
Granted	–	–
Exercised	(76,420)	23.83
Canceled/Forfeited	(57,580)	27.79
Balance at March 31, 2013	246,000	33.00
Granted	–	–
Exercised	(108,000)	30.37
Canceled/Forfeited	(100,000)	38.25
Balance at March 31, 2014	38,000	$ 26.68
Granted	–	–
Exercised	–	–
Canceled/Forfeited	–	–
Balance at December 31, 2014	38,000	26.68
Combined Balance at December 31, 2014	410,000	$ 34.44

[1]See Note 6.

December 31, 2014	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value*
Outstanding	2.4 years	$1,219,407
Exercisable	0.6 years	$419,980

* Excludes August 28, 2014 grant of options to purchase 259,000 shares of common stock at an exercise price of $36.60 as these options will not begin to be exercisable until the occurrence of a transformative transaction intended to increase the market value of the Company's equity for the benefit of shareholders and cannot be modeled under the Black-Scholes pricing model at this time.

At December 31, 2014, the range of exercise prices was $19.19 to $37.02 and the weighted-average remaining contractual life of outstanding options was 2.4 years, excluding the 259,000 shares of non-vested stock options which do not have a set vesting period. The total number of shares of common stock exercisable under both the 2009 Plan and the 1999 Plan at December 31, 2014, was 56,000 shares with a weighted-average exercise price of $26.65. During the quarter ended December 31, 2014, 2,600 options were exercised. During the quarter ended December 31, 2013, 47,000 options were forfeited and 51,720 options were exercised.

Stock Awards

Pursuant to the Capital Southwest Corporation 2010 Restricted Stock Award Plan ("2010 Plan"), our Board of Directors reserved for issuance to certain key employees 188,000 shares of restricted stock. A restricted stock award is an award of shares of our common stock, which generally have full voting and dividend rights but are restricted with regard to sale or transfer. Unless otherwise specified in the award agreement, the restrictions lapse ratably over a specified period of time (generally five years). Restricted stock awards are independent of stock grants and are subject to forfeiture if employment terminates prior to these restrictions lapsing. Unless otherwise specified in the award agreement, these shares vest in equal annual installments over a five-year period from the grant date and are expensed over the five-year vesting period starting on the grant date. On January 16, 2012, the Board of Directors granted 38,600 shares of restricted stock to key employees of the Company. On January 22, 2013, the Board of Directors granted 8,000 shares of restricted stock to officers of the Company. On July 15, 2013, The Board of Directors granted 5,000 shares of restricted stock to a key officer of the Company. On January 20, 2014, the Board of Directors granted 4,800 shares of restricted stock to key employees of the Company. On March 17, 2014, the Board of Directors granted 5,000 shares of restricted stock to a key employee of the Company.

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On August 28, 2014, our Board of Directors amended the 2010 Plan, as permitted pursuant to Section 14 of the 2010 Plan (the “First Amendment to the 2010 Plan”). The First Amendment to the 2010 Plan provides that an award agreement may allow an award to remain outstanding after a spin-off or change in control of one or more wholly-owned subsidiaries of the Company. In addition, on August 28, 2014, the Board of Directors granted 127,000 shares of restricted stock under the 2010 Plan, as amended. These restricted stock awards will not begin to vest until the occurrence of a Trigger Event described in Note 6 above.

The following table summarizes the restricted stock available for issuance as of December 31, 2014:

Restricted stock available for issuance as of March 31, 2014	154,240
Restricted stock granted during the nine months ended December 31, 2014	(127,000)[1]
Restricted stock forfeited during the nine months ended December 31, 2014	4,000
Restricted stock available for issuance as of December 31, 2014	31,240

[1]See Note 6.

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 grant on a straight-line basis over the vesting period. For these purposes, the fair value of the restricted stock award is determined based upon the closing price of our common stock on the date of the grant. For the quarters ended December 31, 2014 and 2013, we recognized total share based compensation expense of $36,001 and ($9,930), respectively, related to the restricted stock issued to our employees and officers. For the nine months ended December 31, 2014 and 2013, we recognized restricted stock compensation expense of $101,214 and $64,050, respectively. We have not recognized any compensation expense related to the 127,000 restricted stock awards granted on August 28, 2014 as these awards are subject to a contingent vesting mechanism.

As of December 31, 2014, the total remaining unrecognized compensation expense related to non-vested restricted stock awards was $499,184, which will be amortized over the weighted-average vesting period of approximately 3.5 years, excluding the 127,000 shares of non-vested restricted stock which do not have a set vesting period.

The following table summarizes the restricted stock outstanding as of December 31, 2014:

Restricted Stock Awards	Number of Shares	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (in Years)
Unvested at March 31, 2014	24,680	$ 30.30	4.1
Granted	127,000[1]	36.60	NA[2]
Vested	–	–	–
Forfeited	(4,000)	22.98	–
Unvested at December 31, 2014	147,680	$ 31.45	3.5

[1]See Note 6.
[2] The 127,000 shares of restricted stock granted on August 28, 2014 will not begin to vest until the occurrence of a transformative transaction intended to increase the market value of the Company’s equity for the benefit of shareholders.

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Phantom Stock Plan

On January 16, 2012, our Board of Directors approved the issuance of 104,000 phantom stock options at an exercise price of $36.74 (Net Asset Value at December 31, 2011) pursuant to the Capital Southwest Corporation Phantom Stock Option Plan to provide deferred compensation to certain key employees. On January 22, 2013, the Board of Directors granted 16,200 shares of phantom stock options at an exercise price of $41.34 per share (Net Asset Value at December 31, 2012) to officers of the Company. On July 15, 2013, the Board of Directors granted 24,000 shares of phantom stock options at an exercise price of $43.80 per share (Net Asset Value at June 30, 2013) to a key officer of the Company. Additionally, the Board of Directors granted 38,000 shares of phantom stock options at an exercise price of $50.25 per share (Net Asset Value at December 31, 2013) to several key employees of the Company in January 2014 and March 2014. 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, adjusted for capital gain dividends declared, will be distributed to plan participants. The estimated liability for phantom stock awards was $483,225 as of December 31, 2014.

There were no phantom stock options granted during the nine months ended December 31, 2014.

Phantom Stock Awards	Number of Shares	Weighted Average Grant Price Per Share	Weighted Average Remaining Vesting Term (in Years)
Unvested at March 31, 2014	95,000	$ 43.59	4.1
Granted	–	–	–
Vested	10,000	36.74	–
Forfeited or expired	3,000	41.34	–
Unvested at December 31, 2014	82,000	$ 44.51	3.2

8. COMMITMENTS

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

CSWC has agreed, subject to certain conditions, to invest up to $270,000 in one portfolio company as of December 31, 2014.

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9. SUMMARY OF PER SHARE INFORMATION

The following presents a summary of per share data for the three and nine months ended December 31, 2014 and 2013.

Per Share Data	Three Months Ended December 31 2014	Three Months Ended December 31 2013	Nine Months Ended December 31 2014	Nine Months Ended December 31 2013
Investment income	$.50	$.55	$.60	$.68
Operating expenses	(.21)	(.18)	(.48)	(.48)
Income taxes	(.01)	.04	(.01)	.05
Net investment income	.28	.41	.11	.25
Distributions from undistributed net investment income	(.10)	(.10)	(.20)	(.20)
Net realized gain/(loss) net of tax	3.66	(.25)	5.63	(.25)
Net increase (decrease) in unrealized appreciation of investments	(5.47)	3.49	(7.96)	7.16
Dividends from capital gains	–	–	–	–
Exercise of employee stock options	–	(.04)	(.01)	(.07)
Stock option expense	.01	–	.02	.02
Forfeiture (Issuance) of restricted stock*	–	.03	(.40)	.04
Increase (decrease) in net asset value	(1.62)	3.54	(2.81)	6.95
Net asset value				
Beginning of period	48.79	46.71	49.98	43.30
End of period	$47.17	$50.25	$47.17	$50.25

*Reflects impact of the different share amounts as a result of issuance or forfeiture of restricted stock during the period.

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

The following discussion should be read in conjunction with the unaudited consolidated financial statements and the notes thereto included under Item 1 of this report and the audited financial statements and the notes thereto and Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our annual report on Form 10-K for the fiscal year ended March 31, 2014 (the “Form 10-K”).

In this quarterly report on Form 10-Q, unless the context otherwise indicates, “we,” “us”, “our” and the “Company” refers to both Capital Southwest Corporation (“CSWC”) and its wholly-owned subsidiary, Capital Southwest Venture Corporation.

We are including the following discussion to inform our existing and potential security holders generally of some of the risks and uncertainties that can affect the Company and to take advantage of the “safe harbor” protection for forward-looking statements that applicable federal securities law affords.

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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, 2014. 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, 2014. 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.

Industrial Co. Spin-off

On December 2, 2014, CSWC announced that its Board of Directors had unanimously approved a plan to spin off certain of its controlled assets into a standalone publicly traded industrial growth company through a distribution to our shareholders of all of the shares of common stock of the new spin-off company (“Industrial Co.”) that would hold, directly or indirectly, the controlled assets. CSWC anticipates that the Industrial Co. will be structured as a C corporation for tax purposes and operate as a diversified industrial growth company initially across two core industries: specialty chemicals and industrial products. Industrial Co. will focus on generating free cash flow by growing organically and through complementary and synergistic acquisitions. Joseph B. Armes, chairman and chief executive officer of CSWC, will continue to serve as chairman of CSWC and is expected to become chairman and chief executive officer of Industrial Co. after the spin-off is completed.

Following the spin-off, the Company anticipates that it will maintain operations as an internally-managed BDC and pursue a credit-focused investing strategy akin to similarly structured organizations. The business will continue to provide capital to middle-market companies. The Company intends to primarily invest in debt securities, including senior “unitranche” debt, second lien and subordinated debt, and may also invest in preferred stock and common stock alongside its debt investments or through warrants.

The Company will remain a regulated investment company (“RIC”) under Subchapter M of the U.S. Internal Revenue Code of 1986. See Note 4 to the notes to the unaudited consolidated financial statements included under Item 1 of this report for a discussion of the Company’s status as an RIC. The Company’s chief investment officer, Bowen S. Diehl, is expected to become chief executive officer of the Company after the spin-off is completed.

The spin-off is expected to be tax-free to shareholders and consummated by the end of the third quarter of 2015, however there can be no assurances regarding the ultimate timing of the transaction or that the transaction will be completed. The spin-off will be contingent upon various conditions, including the approval of our shareholders, the receipt of an order of exemptive relief from the Securities and Exchange Commission, the effectiveness of a Form 10 registration statement filed with the Securities and Exchange Commission, receipt of a favorable opinion and/or ruling with respect to the tax-free nature of the transaction for federal income tax purposes, final approvals of the Board of Directors and other customary conditions. On December 2, 2014, the Company filed a request for exemptive relief with the Securities and Exchange Commission. As of the date of this filing, the Company has not received a response to this request. In addition, as of the date of this filing, the Company has not filed a Form 10 registration statement with the Securities and Exchange Commission. See also Part II: Item 1A “Risk Factors.”

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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 total investment income (consisting of income from interest, dividends and management and other fees) and our combined operating and interest expense, net of applicable income tax expense based on our tax year. The second element is “Net realized gain on investments,” which is the difference between the proceeds received from the disposition of portfolio securities and their stated cost, net of applicable income tax expense based on our tax year. The third element is the “Net increase/decrease in unrealized appreciation of investments,” which is the net change in the market or fair value of our investment portfolio, compared with stated cost. It should be noted that the “Net realized gain/loss on investments” and “Net increase/decrease in unrealized appreciation of investments” are directly related in that when an appreciated portfolio security is sold to realize a gain, a corresponding decrease in net unrealized appreciation occurs by transferring the gain associated with the transaction from 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

Total investment income consisted of dividend income, interest income, management fees and other income for each of the nine months ended December 31, 2014 and December 31, 2013. For the nine months ended December 31, 2014, total investment income was $9,288,551, a $1,106,575, or 10.65%, decrease from total investment income of $10,395,126 for the nine months ended December 31, 2013. Interest income from portfolio companies decreased by $472,388, or 66.1% from $715,040 for the nine months ended December 31, 2013 to $242,652 for the nine months ended December 31, 2014. PalletOne was sold in March 2014 and we ceased accruing interest from i-Memories at the beginning of the year. Interest income from temporary cash investments increased by $18,279 or 35.3% from $51,729 for nine months ended December 31, 2014 to $70,008 for the nine months ended December 31, 2013.

The Company’s management fees, received primarily from its controlled affiliates, totaled $419,850 for both the nine months ended December 31, 2014 and 2013.

During the three and nine months ended December 31, 2014 and 2013, the Company recorded dividend income from the following sources:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Alamo Group, Inc.	$138,832	$198,311	$535,452	$594,882
Capitala Finance Corporation	15,310	50,809	66,120	50,809
CapStar Holdings Corp	-	350,000	-	350,000
Encore Wire Corporation	19,138	52,500	45,388	105,000
North American Energy Partners	–	–	1,190	–
The RectorSeal Corporation	7,240,000	6,200,000	7,720,000	6,680,000
TCI Holdings, Inc.	–	20,318	–	60,953
The Whitmore Manufacturing Company	60,000	1,200,000	180,000	1,320,000
	$7,473,279	$8,071,938	$8,548,150	$9,161,644

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Due to the nature of our business, the majority of our operating expenses are related to employees' and directors' compensation, office expenses, legal, professional and accounting fees and pension benefit. Total operating expenses did not materially change for the nine months ended December 31, 2014 as compared to the nine months ended December 31, 2013. Salary expense decreased by $1,586,510 due to a decrease of approximately $720,000 in phantom stock option expense and approximately $715,000 relating to certain staffing changes in the prior year. The salary expense decrease was offset by an increase in professional fees of $1,389,000 primarily due to legal fees incurred related to Alamo Group's secondary offering and the review of strategic alternatives in the current year.

Net Realized Gain (Loss) on Investments

During the nine months ended December 31, 2014, we recognized a net realized gain of $141,909,237 consisting of the difference between $170,598,426 of proceeds from disposition of investments and $28,689,189 cost from investments derived from the following sources:

	Proceeds	Cost	Realized gain (loss)
Alamo Group, Inc.	$114,975,105	$2,190,937	$112,784,168
Capitala Finance Corporation	2,019,661	1,363,799	655,862
Capital South Partners Fund III	34,054	34,054	-
Cinatra Clean Technologies, Inc.	2,458,706	17,288,383	(14,829,677)
Discovery Alliance, LLC	139,713	1,315,000	(1,175,287)
Encore Wire Corporation	49,544,138	5,200,000	44,344,138
North American Energy Partners	588,577	236,986	351,591
StarTech Seed Fund II	131,544	131,544	-
Tristate Capital Holdings, Inc.	706,928	928,486	(221,558)
Total realized gain	$170,598,426	$28,689,189	$141,909,237

During the nine months ended December 31, 2013, we received a capital gain dividend of $55,000 from Diamond State Venture, L.P.

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 nine months ended December 31, 2014, we recognized a decrease of $123,790,970 in the net change in unrealized appreciation of investments, of which $192,854,050 of the decrease is related to investments sold during the year and offset by a $69,063,080 increase in unrealized appreciation for assets still held at December 31, 2014. This decrease in unrealized appreciation is primarily attributable to the sale of 2,831,300 shares of Alamo Group, Inc. via a share buy-back transaction with the Company and a secondary offering which generated a net realized gain of $112,784,168; the sale of our entire holdings of Encore Wire Corporation stock, which generated a net realized gain of $44,344,138. In addition, Instawares Holding Company, LLC, iMemories, Inc., Trax Holdings, Inc. and Deepwater Corrosion Services, Inc. decreased by $2,879,000, $2,112,002, $1,500,000, and $1,144,000, respectively, due to each entity's under performance in their respective markets. These decreases are offset by The Rectorseal Corporation, Titanliner, Inc., and KBI Biopharma, Inc., which increased by $59,500,000, $7,166,999, and $4,500,000, respectively, due to increases in each entity's earnings, several add-on acquisitions and increases in valuation multiples based on market changes. Additionally, Wellogix, Inc. and Boxx Tehcnologies, Inc. increased by $4,480,000 and $1,326,000 respectively due to the utilization of a market valuation approach for these two companies.

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For the nine months ended December 31, 2013, we recognized a $109,315,301 increase in net change in unrealized appreciation of investments. The increases in unrealized appreciation are attributable to Alamo Group, Inc. and Encore Wire Corporation, which increased by $63,553,497 and $25,068,750, respectively, due to increases in their stock price at December 31, 2013, while The Rectorseal Corporation increased by $19,000,000; The Whitmore Manufacturing Company increased by $2,500,000; Media Recovery, Inc. increased by $5,300,000; and Trax Holdings, Inc. increased by $1,900,000 due to increases in each entity's respective earnings. Offsetting these increases were Cinatra Clean Technologies, Inc., TitanLiner Inc., and Instawares Holding Company, LLC., which decreased by $2,328,844, $3,414,000, and $2,323,000, respectively, due to each entity's under performance in their respective markets. In addition, CapitalSouth Partners Fund III, L.P. decreased by $2,833,201; during the nine months ended December 31, 2013 due to a distribution of 108,105 shares of Capitala Finance Corporation (CPTA) valued at $2,151,290, which represented 71% of our interest in Capital South Partners Fund III, L.P.

Set forth in the following table are the ten most significant increases and decreases in unrealized appreciation by our current portfolio companies:

	Nine Months Ended December 31,	
	2014	2013
The RectorSeal Corporation	59,500,000	19,000,000
TitanLiner, Inc.	7,166,999	(3,414,000)
KBI Biopharma, Inc.	4,500,000	1,700,000
Wellogix, Inc.	4,480,000	-
Boxx Technologies, Inc.	1,326,000	(220,000)
Instawares Holding Company, LLC	(2,879,000)	(2,323,000)
iMemories, Inc.	(2,112,002)	-
Trax Holdings, Inc.	(1,500,000)	1,900,000
Deepwater Corrosion Services, Inc.	(1,144,000)	-
The Whitmore Manufacturing Company	(900,000)	2,500,000

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 – December 31, 2014(unaudited) and March 31, 2014."

Financial Liquidity and Capital Resources

At December 31, 2014, the Company had cash and cash equivalents of approximately $249 million. Funds may be transferred to the Company in the form of dividends from our controlled affiliates to the extent available.

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.

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Application of Critical Accounting Policies and Accounting Estimates

There have been no changes during the nine months ended December 31, 2014 to the critical accounting policies or areas 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, 2014.

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. 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 $2,965,507 at December 31, 2014, equivalent to 0.56% 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.

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.

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 Chief Executive Officer and the 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, management, including our President and Chief Executive Officer and our Chief Financial Officer, have concluded that our current disclosure controls and procedures are effective as of December 31, 2014.

During the nine months ended December 31, 2014, 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.

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PART II. – OTHER INFORMATION

Item 1. Legal Proceedings

We may, from time to time, be involved in material 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 or pending material legal proceedings to which we are party or to which any of our assets is subject.

Item 1A. Risk Factors

In addition to the risk factor below and the other information in this report on Form 10-Q, the risk factors disclosed in Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014 are some of the factors that could materially affect our business, financial condition or future result:

The proposed spin-off is contingent upon the satisfaction of a number of conditions, may not be completed in the expected time frame or at all, may require significant time and attention of our management, may not receive the expected tax treatment or achieve the intended results or benefits, and any difficulties in connection with the spin-off could have an adverse effect on us.

We plan to pursue a spin-off of certain of our control assets into a standalone publicly traded industrial growth company through a distribution to our shareholders of all of the shares of common stock of a subsidiary that would hold, directly or indirectly, the control assets. The spin-off will be contingent upon various conditions, including the approval of our shareholders, the receipt of an order of exemptive relief from the Securities and Exchange Commission, the effectiveness of a Form 10 registration statement filed with the Securities and Exchange Commission, receipt of a favorable opinion and/or ruling with respect to the tax-free nature of the transaction for federal income tax purposes, final approvals of the Board of Directors and other customary conditions. For these and other reasons, the spin-off may not be completed in the anticipated time frame or at all. Additionally, execution of the proposed spin-off will likely require significant time and attention of our management, which could distract management from the operation of our business and the execution of our other strategic initiatives. Further, if the spin-off is completed, it may not achieve the intended results or benefits. Any such difficulties could have an adverse effect on our business, results of operations or financial condition.

Item 6. Exhibits

Exhibit No.	Description
31.1	Certification of President and Chief Executive Officer required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), filed herewith.
31.2	Certification of Chief Financial Officer required by Rule 13a-14(a) of the Exchange Act, filed herewith.
32.1	Certification of President and Chief Executive 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.
32.2	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.

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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

February 6, 2015	By:	/s/ Joseph B. Armes
Date		Joseph B. Armes Chairman of the Board President and Chief Executive Officer
February 6, 2015	By:	/s/ Kelly Tacke
Date		Kelly Tacke Chief Financial Officer

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