To Our Shareholders

Net asset value at March 31, 2000 was $236,875,966, equivalent to $62.09 per share after deducting an allowance of $21.80 per share for deferred taxes on net unrealized appreciation of investments. Assuming reinvestment of all dividends and tax credits on retained long-term capital gains, the March 31, 2000 net asset value of $62.09 was 5.1% below the March 31, 1999 net asset value of $67.16 per share and 17.9% below the March 31, 1998 net asset value of $78.15 per share.

This severe decline mirrored the market's disenchantment with small-capitalization stocks and the increasingly difficult industry climates that confront our major investments in the manufactured housing, wire and cable, mowing equipment, envelope and printing, and cemetery and funeral industries. Over the past two years, the unrealized gains on the six investments in companies engaged in these industries declined by $121,147,146. The following table shows the changes in the values of each of these six investments and the other components that affect net asset value:

	Year Ended March 31, 2000	Two Years Ended March 31, 2000
Increase (decrease) in unrealized gains:		
Palm Harbor Homes	$ (39,276,000)	$ (51,844,000)
American Homestar	(4,224,707)	(15,772,239)
Encore Wire	(2,724,000)	(21,737,000)
Alamo Group	7,276,953	(13,338,047)
Mail-Well	(5,241,000)	(11,455,860)
Skylawn	-	(7,000,000)
	(44,188,754)	(121,147,146)
Other changes in unrealized gains	6,116,964	19,641,811
Net decrease in unrealized gains	(38,071,790)	(101,505,335)
Decrease in deferred taxes	13,322,000	35,523,000
Realized gains	9,231,442	10,762,133
Other changes in net assets	(3,837,651)	(3,926,648)
Decrease in net assets	$(19,355,999)	$(59,146,850)

Measures of Performance and Value

Conventional investment company reporting focuses primarily on the amounts and trends of net asset value, obscuring the fundamental importance of the real businesses owned indirectly by Capital Southwest shareholders. Four of our most significant enterprises, all of which have been held for more than 20 years, represent nearly three-fifths of the total value of our Company's investments at March 31, 2000. The profile of each of these companies, described under Four Major Investments on pages 2 and 3, underscores their quality and confirms the validity of our long-term investment philosophy.

As illustrated by the bar graph on the opposite page, Capital Southwest's net asset value per share increased from $5.82 at March 31, 1980 to $78.15 at March 31, 1998, then declined for two years to $62.09 at March 31, 2000. The growth in net asset value over the past 20 years corresponded to a compound annual rate of 16.3%, assuming shareholders reinvested all dividends and tax credits on long-term capital gains retained by the Company. On the same basis, the growth over the 10-year period ended March 31, 2000 was equivalent to a compound annual rate of 13.1%.

These significantly lower 10 and 20 year growth rates were influenced by Capital Southwest's poor performance during the past two years, a period in which the Standard & Poor's 500 Stock Index was racing ahead. Although our long-term investment results exceeded the S&P 500 Index for many years, the following table shows the extent to which our Company's performance is now below the performance of this benchmark:

Period Ended March 31, 2000	Investment Returns: *Capital Southwest	Investment Returns: **S&P 500 Stock Index
10 years	13.1%	18.8%
20 years	16.3	18.3

* Compound annual return for Capital Southwest based on net asset value per share assuming reinvestment of dividends and tax credits.

** Compound annual return for the S&P 500 Stock Index assuming reinvestment of dividends. Comparison of our performance with this Index is provided, not because of similarity between our investments and the stocks in the Index, but because the S&P 500 is a widely-followed benchmark which represents a large majority of the market value of all publicly-owned companies.

Capital Southwest, unlike most investment companies, reports its net asset value after deducting deferred taxes on unrealized appreciation of investments. Because Capital Southwest has a long-term investment perspective, it is probable that a large proportion of our successful investments will be retained for many years. Meanwhile, the amount of the deferred tax liability is represented by assets which are working for the benefit of our shareholders. If net assets were increased by the amount of this deferred tax liability, the pro forma March 31, 2000 net asset value would be $83.89 per share. On this basis, the 20 year return percentage shown in the preceding table would increase to 17.3%.

Shareholders should be aware that past results are not indicative of future performance. Achieving sustained growth, even at a lower rate, is more difficult as our asset base grows and is more dependent on a small number of key investments. Shareholders should also be aware that future market prices of our stock may be above or below net asset value, and therefore the performance of Capital Southwest stock may differ materially from the net asset value performance described in our reports.

The following analysis of a share of Capital Southwest stock shows the composition of the assets and liabilities underlying each share:

	Value Per Share	
Major investments:		
Palm Harbor Homes, Inc.	$22.65	
The RectorSeal Corporation	11.01	
Skylawn Corporation	9.17	
Alamo Group Inc.	6.66	$ 49.49
Other investments:		
Restricted securities	22.00	
Marketable securities	13.34	35.34
Cash and other assets		18.07
Total assets		102.90
Deferred taxes		(21.88)
Long-term debenture and other liabilities		(18.93)
Net assets at March 31, 2000		$ 62.09

The value of our investments in the 18 portfolio companies which have publicly-owned stocks amounted to $49.79 per share of Capital Southwest stock. After deducting deferred taxes, the net value of such stocks was $35.32 per Capital Southwest share, including the $25.69 net value of restricted publicly-owned securities. It should be noted that the net (after-tax) value of our Palm Harbor Homes investment was $15.72 per Capital Southwest share, equivalent to 25.3% of net assets at March 31, 2000. In addition to Palm Harbor, the stocks of Alamo Group, Encore Wire and Mail-Well are subject to resale restrictions because of our ownership percentage or board representation. Therefore, the restricted securities of these companies were valued below their March 31, 2000 market prices. The extent to which such valuations discount the market prices of these companies' freely-tradable stocks is an appropriate reflection of Capital Southwest's long-term investment philosophy and our tendency to hold investments through unfavorable business and market cycles.

In addition to a complete list of our investments, this report includes detailed information on our twelve largest holdings. These twelve investments had a combined cost of $40,529,940 and a combined value of $271,976,515, representing 84.0% of the value of our investment portfolio at March 31, 2000.

Four Major Investments

Four of our major holdings are Palm Harbor Homes, Inc., The RectorSeal Corporation, Skylawn Corporation and Alamo Group Inc. At March 31, 2000, investments in these companies had an aggregate cost of $17,560,002 and a value of $188,798,000 ($49.49 per Capital Southwest share); their net value after deducting an allowance for deferred taxes was $129,174,135 ($33.86 per Capital Southwest share). Our Company's equity in their earnings for the most recently completed fiscal years was $22,788,000 ($5.97 per Capital Southwest share). At $49.49 per share, the aggregate value of our investments in these companies is equivalent to a price/earnings ratio of 8.3 - far below the March 31, 2000 ratios of 23.6 for the Dow Jones Industrials, 31.1 for the Standard & Poor's 500 and 176.3 for the Nasdaq Composite Index.

At March 31, 2000, the combined value of our four major investments was 58.3% of the value of our total investment portfolio. In view of the importance of each of these companies to Capital Southwest, their businesses, markets, operating results and valuations are summarized in the following paragraphs:

Palm Harbor Homes, Inc. (Nasdaq: PHHM), Dallas, Texas, was financed by Capital Southwest when it was founded in 1977 by its chairman, Lee Posey, a legendary veteran of the manufactured housing industry. Known for its superior multi-section designs and its commitment to customer satisfaction, Palm Harbor has consistently outperformed its competitors as it established a total of 15 manufacturing plants, over 200 independent dealers and 133 company-owned retail outlets, which sell approximately 79% of the homes manufactured by the company. Last year, Palm Harbor sold over 14,000 homes in 30 states. Its integrated operations include an insurance company, Standard Casualty Company, and a finance company, Countryplace Mortgage, Ltd. Since 1997, Larry Keener, a 20 year employee of Palm Harbor and an industry veteran, has served as the company's chief executive officer. Despite the manufactured housing industry's continuing sales decline and resulting overcapacity, Palm Harbor recorded sales of $777,471,000 and earnings of $38,596,000 ($1.66 per share) for the year ended March 31, 2000. The closing market bid price on March 31 was $15.00. Capital Southwest owns 7,855,121 shares (a 34.2% equity interest) at a cost of $10,931,955 and a value (at $11.00 per share) of $86,406,000 – 6.5 times our $13,200,000 equity in Palm Harbor's earnings. During the past five years, Palm Harbor's sales grew by 135.2%.

The RectorSeal Corporation, Houston, Texas, acquired in 1967 by Capital Southwest, produces chemical specialty products including thread sealants, firestop sealants, plastic solvent cements and other compounds for plumbing, air conditioning, electrical, construction and industrial applications. Its subsidiaries include Jet-Lube, acquired in 1973, a manufacturer of anti-seize compounds and lubricants for oil field and industrial uses, and Cargo Chemical, acquired in 1999, producer of a line of automotive chemicals such as engine block sealants and epoxy putty. The distinctive specialty products of RectorSeal and its subsidiaries are produced in four plants in the United States, one plant in Canada and one plant in England and are sold through more than 8,000 distributors and retailers. Since 1991, David Smith, a 23 year employee, has been president of RectorSeal and since 1995, Larry Eubanks, a 26 year employee, has been president of its major subsidiary, Jet-Lube. RectorSeal's earnings, derived from both internal growth and acquisitions, reflect the strength of its several lines of proprietary, branded products. For the year ended March 31, 2000, RectorSeal reported sales of $53,858,000 and earnings of $4,988,000. Capital Southwest owns 100% of RectorSeal at a cost of $52,600 and a value of $42,000,000 – 8.4 times RectorSeal's earnings. During the past five years, RectorSeal's sales grew by 114.4%.

Skylawn Corporation, Hayward, California, initially financed by Capital Southwest in 1966 and subsequently acquired in total, owns and operates cemeteries, mausoleums and funeral homes in San Mateo, Hayward, Oakland, Sacramento and Napa, California. The company also offers its clients pre-need arrangements by means of a captive insurance company and funeral and cemetery trusts. Skylawn Memorial Park, with approximately 250 developable acres (a 100 year supply of land), is the San Mateo area's major cemetery and accounts for over 40% of the company's revenue. Since 1998, Andy Bryant, former chief financial officer and a six year employee, has served as Skylawn's president. Skylawn's revenue recognition and other accounting practices are believed to be more conservative than the publicly-owned cemetery/funeral home consolidators. To establish uniform revenue recognition standards in its most recent financial statements, Skylawn adopted a change in accounting principle applicable to income from cemetery trusts. On this basis, for the year ended March 31, 2000, Skylawn reported revenue of $24,574,000 and net income of $2,940,000, equivalent to net income of $4,163,000 before the change in accounting principle. Capital Southwest owns 100% of Skylawn at a cost of $4,510,400 and a value of $35,000,000 – 11.9 times Skylawn's earnings. During the past five years, Skylawn's revenue grew by 17.0%.

Alamo Group, Inc. (NYSE: ALG), Seguin, Texas, was financed by Capital Southwest in 1969 when it was founded by Donald J. Douglass, a venture capitalist who is currently chairman of the Alamo board. Alamo manufactures several lines of tractor-mounted mowing equipment and other vegetation maintenance products and replacement parts for governmental, industrial and agricultural applications. The acquisition of Schwarze Industries in February 2000 expanded Alamo's business to include power-sweeping equipment for streets, parking areas, airports and other governmental uses. Alamo's manufacturing operations include seven plants in the United States and four in Europe. In July 1999, Ron Robinson, an experienced manager with a strong track record, joined Alamo Group as its chief executive officer. For the year ended December 31, 1999, Alamo reported sales of $176,608,000 and net income of $6,102,000 ($0.63 per share). The closing market price on March 31 was $11.625. Capital Southwest owns 2,821,300 shares (a 27.2% equity interest) at a cost of $2,065,047 and a value (at $9.00 per share) of $25,392,000 – 15.3 times our $1,660,000 equity in Alamo's earnings. During the past five years, Alamo's sales grew by 47.6%

Building Blocks

Capital Southwest is generally classified as a venture capital company, although a more accurate term is a business development company in view of our concentration on developing the fundamental values of our holdings over many years. As our Company evolves and we retain many of our successful ventures, our investments fall into one of three categories: 1) holding company type assets including the four major investments discussed in the preceding section and other 25% to 100% owned long-term investments, 2) venture capital assets and 3) marketable (unrestricted) securities. As of March 31, 2000, we classify our portfolio as follows:

	Cost	Value	%
Holding company assets (mainly Palm Harbor, RectorSeal, Skylawn, Alamo and Whitmore)	$20,050,922	$198,708,760	61.4
Venture capital assets	54,691,674	74,028,203	22.9
Marketable securities	10,259,841	50,892,172	15.7
Total investments	$85,002,437	$323,629,135	100.0

The building blocks in our portfolio change as investments are added and subtracted, as they grow or fail to grow and as they are influenced by economic and cyclical conditions. The size of the holding company category has grown dramatically during the past decade as successful venture investments have prospered and entered this category.

Our portfolio is dominated by traditional companies that generate strong earnings, but we continue to make limited investments in varied early stage, high risk technology companies that generate significant current losses in hopes of achieving more significant future earnings. At March 31, 2000, investments in seven early-stage technology companies represented 2.6% of the value of our portfolio.

Investment Activity

Excluding short-term loans totaling $4,000,000 to one of our portfolio companies, an aggregate of $17,924,423 was invested during the year, including $6,115,047 in additions to existing investments and $11,809,376 in the following new investments:

- $5,000,000 in Organized Living, Inc. of Lenexa, Kansas, a specialty retailer of home and office organization and storage products sold through nine stores in eight metropolitan areas.
- $3,000,000 in International Talk.com, Inc. of Austin, Texas, which provides Internet-based retail and wholesale long distance communications to and from foreign countries.
- $1,137,500 in VocalData, Inc. of Richardson, Texas, a developer of Voice Over Internet Protocol customer premises telephony equipment.
- $1,100,001 in iChoose, Inc. of Carrollton, Texas, which offers online merchant partners a means of luring customers from competitors' Internet websites at the point of purchase.
- $1,000,000 in PaylinX Corporation of Reston, Virginia, which provides enterprise payment solutions to both traditional and e-commerce merchants for processing electronic credit card payments from customers.
- $500,000 in BOXX Technologies, Inc. of Austin, Texas, which designs and manufactures high-performance computer workstations for computer graphics imaging and design.
- $71,875 investment of a $250,000 commitment to Diamond State Ventures, L.P. of Little Rock, Arkansas, a newly-formed small business investment company focusing mainly on opportunities in Arkansas and adjacent states.

Additional amounts invested in existing portfolio companies included $3,000,000 in Airformed Composites, Inc., $600,000 in CDC Technologies, Inc., $750,000 in Dyntec, Inc. and $275,000 in StarTech Seed Fund I. Also, $1,490,047 was invested in open market purchases of the stock of Alamo Group Inc.

The Amfibe Score

In June 1994, $200,000 was invested in Amfibe, Inc. of Martinsville, Virginia, a new company formed to acquire a very small nylon filament operation from DuPont. Only a blind contrarian would invest in an insignificant company in an archaic textile business, but fortunately we did. Nearly six years later, in April 2000, the stock of Amfibe was sold for over $15 million and Capital Southwest's 40% equity interest yielded a total of approximately $6.2 million – 31 times our investment.

How could an old, old-economy company generate a gain that only an Internet company would deserve? All it had were strong earnings potential and seasoned managers who had a fierce determination to build a real business. Perhaps it was the management after all.

Therefore, we salute two top-notch entrepreneurs:

- Larry McDorman, Amfibe's president, a 20 year veteran of DuPont with a degree in electrical engineering and an MBA, who traded his security blanket for this high risk opportunity and made it happen.
- Ken Martin, Amfibe's vice president of operations, a 29 year veteran of DuPont with a degree in industrial arts, who left the peaceful corporate fold to engage in combat on the frontier of capitalism.

Thanks a $6 million!

Where Do We Go From Here?

This is an appropriate question in view of our Company's two year decline in value while the market was soaring to new highs and a growing chorus of incredibly ignorant investors was proclaiming that earnings were unimportant.

The simple, straightforward answer is that we will adhere to the investment philosophy that has served us well for four decades and has propelled the value of our Company's stock from $0.56 per share twenty-five years ago to $54.75 on March 31, 2000. In executing our established investment philosophy (outlined on page 6) we will:

- Select new investment opportunities based on a painstaking analysis of fundamental values and perceived risks and rewards, ignoring the illusion that there is a free lunch.
- Maintain a stubborn price discipline focused on the present value of future earnings, ignoring the herd mentality of other investors.
- Build lasting foundations for real businesses that will benefit their owners (our shareholders) for generations, ignoring the common belief that gains on promising businesses should be harvested (or flipped).
- Develop the value of the major businesses that are cornerstones of our Company, ignoring the constantly changing fashions pursued by myopic market timers.
- Sacrifice short-term results to enhance long-term earnings growth, ignoring the opportunists whose long-term vision is three months.
- Support the entrepreneurs whose inspiration and dedication are the catalysts that create value, ignoring the impatience of those who have never scrambled to meet a payroll.
- Send money to Washington as a last alternative after exploring all tax-avoidance strategies, ignoring the voracious appetites of the Architects of the Welfare State.

A Voice Crying in the Wilderness

My constant questioning of the market's sanity is not consoling to our shareholders (including me) who have seen the value of our stock plummet during the past two years. However, as indicated in the following extract from a letter I just received, a courageous new shareholder is joining our battered ranks:

"When the market opens today, I will resign myself and my money to purchasing shares of CSWC and your boring efforts. Thank you so much for a breath of fresh air in the madness of the crowd. You are a voice crying in the wilderness and I heard you."

William R. Thomas

June 2, 2000

President and Chairman