

CAPITAL SOUTHWEST CORP
Form 10-Q
February 05, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2018

OR

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

For the transition period fromto

Commission File Number: 814-00061

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

Texas 75-1072796
(I.R.S.
(State or other jurisdiction of incorporation Employer
or organization) Identification
No.)

5400 Lyndon B Johnson Freeway, Suite 1300, Dallas, Texas 75240
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (214) 238-5700

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company
(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

17,233,385 shares of Common Stock, \$0.25 value per share, as of February 1, 2019.

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PART I – FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

(In thousands, except shares and per share data)

	December 31, 2018 (Unaudited)	March 31, 2018
Assets		
Investments at fair value:		
Non-control/Non-affiliate investments (Cost: \$285,698 and \$200,981, respectively)	\$ 287,246	\$ 199,949
Affiliate investments (Cost: \$78,980 and \$51,648, respectively)	77,866	53,198
Control investments (Cost: \$89,971 and \$82,768, respectively)	131,628	139,948
Total investments (Cost: \$454,649 and \$335,397, respectively)	496,740	393,095
Cash and cash equivalents	10,774	7,907
Receivables:		
Dividends and interest	7,773	5,219
Escrow	370	119
Other	681	447
Income tax receivable	167	109
Deferred tax asset	2,294	2,050
Debt issuance costs (net of accumulated amortization of \$1,634 and \$1,041, respectively)	3,533	2,575
Other assets	1,449	5,969
Total assets	\$ 523,781	\$ 417,490
Liabilities		
Notes (Par value: \$77,136 and \$57,500, respectively)	\$ 74,960	\$ 55,305
Credit facility	122,000	40,000
Other liabilities	6,280	6,245
Dividends payable	—	4,525
Accrued restoration plan liability	2,865	2,937
Deferred income taxes	—	190
Total liabilities	206,105	109,202
Commitments and contingencies (Note 11)		
Net Assets		
Common stock, \$0.25 par value: authorized, 25,000,000 shares; issued, 19,572,934 shares at December 31, 2018 and 18,501,298 shares at March 31, 2018	4,893	4,625
Additional paid-in capital	276,899	260,713
Total distributable earnings	59,821	66,887
Treasury stock - at cost, 2,339,512 shares	(23,937)	(23,937)
Total net assets	317,676	308,288
Total liabilities and net assets	\$ 523,781	\$ 417,490
Net asset value per share (17,233,422 shares outstanding at December 31, 2018 and 16,161,786 shares outstanding at March 31, 2018)	\$ 18.43	\$ 19.08

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

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except shares and per share data)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
Investment income:				
Interest income:				
Non-control/Non-affiliate investments	\$7,744	\$ 5,420	\$20,825	\$ 14,858
Affiliate investments	1,886	142	5,136	423
Control investments	440	—	983	—
Dividend income:				
Non-control/Non-affiliate investments	95	31	120	91
Affiliate investments	—	—	82	—
Control investments	3,257	3,118	9,383	9,221
Interest income from cash and cash equivalents	12	4	21	16
Fees and other income	437	304	1,022	643
Total investment income	13,871	9,019	37,572	25,252
Operating expenses:				
Compensation	2,007	1,885	5,880	5,129
Spin-off compensation plan	—	172	—	517
Share-based compensation	607	479	1,564	1,231
Interest	3,347	1,275	8,829	2,924
Professional fees	390	245	1,285	1,205
Net pension expense	40	42	119	123
General and administrative	704	620	2,322	2,171
Total operating expenses	7,095	4,718	19,999	13,300
Income before taxes	6,776	4,301	17,573	11,952
Income tax (benefit) expense	101	(362)	) 736	(84)
Net investment income	\$6,675	\$ 4,663	\$ 16,837	\$ 12,036
Realized gain				
Non-control/Non-affiliate investments	\$1,849	\$ 527	\$2,066	\$ 1,361
Affiliate investments	—	90	77	90
Control investments	34	—	18,653	—
Total net realized gain on investments before income tax	1,883	617	20,796	1,451
Net unrealized (depreciation) appreciation on investments				
Non-control/Non-affiliate investments	(4,860)	) 708	1,549	(3,458)
Affiliate investments	(95)	) (173)	) (1,634)	) (827)
Control investments	564	4,500	(15,523)	) 14,995
Income tax (provision) benefit	153	(72)	) 535	133
Total net unrealized (depreciation) appreciation on investments, net of tax	(4,238)	) 4,963	(15,073)	) 10,843
Net realized and unrealized (losses) gains on investments	\$ (2,355)	\$ 5,580	\$ 5,723	\$ 12,294
Net increase in net assets from operations	\$4,320	\$ 10,243	\$22,560	\$ 24,330

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Pre-tax net investment income per share - basic and diluted	\$0.40	\$ 0.27	\$1.06	\$ 0.74
Net investment income per share – basic and diluted	\$0.39	\$ 0.29	\$1.02	\$ 0.75
Net increase in net assets from operations – basic and diluted	\$0.25	\$ 0.64	\$1.36	\$ 1.52
Weighted average shares outstanding – basic	17,120,357	16,104,806	16,541,102	16,041,696
Weighted average shares outstanding – diluted	17,122,923	16,176,436	16,543,524	16,109,122

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

CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

(Unaudited)
(In thousands)

	2018		2017
Net assets, March 31	\$ 308,288		\$ 285,072
Operations:			
Net investment income	4,617		3,436
Net realized gain on investments	18,819		624
Net unrealized (depreciation) appreciation on investments, net of tax	(11,783)	)	1,384
Net increase in net assets from operations	11,653		5,444
Dividends to shareholders (\$0.89 and \$0.21 per share, respectively)	(14,503)	)	(3,355)
Spin-Off Compensation Plan, net of tax benefit of \$ - and \$59, respectively	—		(114)
Capital share transactions:			
Change in pension plan funded status	11		12
Exercise of employee stock options	1,457		—
Share-based compensation expense	475		368
Common stock withheld for payroll taxes upon vesting of restricted stock	—		—
(Decrease) increase in net assets	(907)	)	2,355
Net assets, June 30	\$ 307,381		\$ 287,427
Operations:			
Net investment income	5,546		3,937
Net realized gain on investments	94		210
Net unrealized appreciation on investments, net of tax	948		4,496
Net increase in net assets from operations	6,588		8,643

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Dividends to shareholders (\$0.44 and \$0.24 per share, respectively)	(7,191))	(3,838))
Spin-Off Compensation Plan, net of tax benefit of \$ - and \$58, respectively	—		(113))
Capital share transactions:				
Change in pension plan funded status	12		11	
Exercise of employee stock options	576		—	
Share-based compensation expense	482		384	
Common stock withheld for payroll taxes upon vesting of restricted stock	—		—	
Increase in net assets	467		5,087	
Net assets, September 30	\$ 307,848		\$ 292,514	
Operations:				
Net investment income	6,675		4,663	
Net realized gain on investments	1,883		617	
Net unrealized (depreciation) appreciation on investments, net of tax	(4,238)	)	4,963	
Net increase in net assets from operations	4,320		10,243	
Dividends to shareholders (\$0.46 and \$0.26 per share, respectively)	(7,932)	)	(4,202))
Spin-Off Compensation Plan, net of tax expense of \$ - and \$258, respectively	—		(432))
Capital share transactions:				
Change in pension plan funded status	11		13	
Issuance of common stock	13,124		—	
Exercise of employee stock options	69		—	
	607		479	

Share-based compensation expense				
Common stock withheld for payroll taxes upon vesting of restricted stock	(186	)	(85)
Repurchase of common stock	(185)	—	
Increase in net assets	9,828		6,016	
Net assets, December 31	\$	317,676	\$	298,530

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended December 31,	
	2018	2017
Cash flows from operating activities		
Net increase in net assets from operations	\$22,560	\$24,330
Adjustments to reconcile net increase in net assets from operations to net cash used in operating activities:		
Purchases and originations of investments	(197,088)	(144,242)
Proceeds from sales and repayments of debt investments in portfolio companies	64,986	75,520
Proceeds from sales and return of capital of equity investments in portfolio companies	33,928	104
Payment of accreted original issue discounts	465	1,346
Depreciation and amortization	1,052	604
Net pension benefit	(38)	(35)
Realized gain on investments before income tax	(20,796)	(1,451)
Net unrealized depreciation (appreciation) on investments	15,608	(10,710)
Accretion of discounts on investments	(1,054)	(592)
Payment-in-kind interest and dividends	(383)	(215)
Stock option and restricted awards expense	1,564	1,231
Deferred income taxes	(434)	(508)
Changes in other assets and liabilities:		
Increase in dividend and interest receivable	(2,426)	(973)
Decrease in escrow receivables	310	426
Increase in tax receivable	(58)	—
(Increase) decrease in other receivables	(233)	159
Decrease in other assets	4,442	2,280
Increase in taxes payable	683	—
(Decrease) increase in other liabilities	(648)	1,253
Net cash used in operating activities	(77,560)	(51,473)
Cash flows from financing activities		
Proceeds from common stock offering	13,230	—
Equity offering costs paid	(92)	—
Borrowings under credit facility	127,000	66,000
Repayments of credit facility	(45,000)	(56,000)
Debt issuance costs paid	(1,816)	(1,691)
Proceeds from notes	19,524	55,775
Dividends to shareholders	(34,151)	(14,384)
Proceeds from exercise of employee stock options	2,103	—
Repurchase of common stock	(185)	—
Common stock withheld for payroll taxes upon vesting of restricted stock	(186)	(86)
Net cash provided by financing activities	80,427	49,614
Net increase in cash and cash equivalents	2,867	(1,859)
Cash and cash equivalents at beginning of period	7,907	22,386
Cash and cash equivalents at end of period	\$10,774	\$20,527

Supplemental cash flow disclosures:

Cash paid for income taxes	\$11	\$290
Cash paid for interest	7,647	2,232
Supplemental disclosure of noncash financing activities:		
Dividend declared, not yet paid	\$—	\$4,201
Spin-off Compensation Plan distribution accrued, not yet paid	—	517

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

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CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

December 31, 2018

Portfolio Company ¹	Type of Investment ^{2, 15}	Industry	Current Interest Rate ³	Maturity	Principal	Cost	Fair Value ⁴
Non-control/Non-affiliate Investments ⁵							
AAC HOLDINGS, INC.	First Lien	Healthcare services	L+6.75% (Floor 1.00%)/Q, Current Coupon 9.28%	6/30/2023	\$9,143,750	\$8,961,902	\$9,120,891
ACE GATHERING, INC.	Second Lien ¹⁷	Energy services (midstream)	L+8.50% (Floor 2.00%)/Q, Current Coupon 11.30%	12/13/2023	10,000,000	9,801,711	9,801,711
ADAMS PUBLISHING GROUP, LLC	First Lien	Media, marketing & entertainment	(Floor 1.00%)/Q, Current Coupon 9.93%	7/2/2023	14,250,000	13,983,051	13,979,250
	Delayed Draw Term Loan ¹⁰		L+7.50% (Floor 1.00%)	7/2/2023	—	(31,146)	—
						13,951,905	13,979,250
AG KINGS HOLDINGS INC. ^{8,18}	First Lien	Food, agriculture & beverage	L+10.02% (Floor 1.00%)/M, Current Coupon 12.69%	8/8/2021	9,307,692	9,197,504	8,618,923
ALLIANCE SPORTS GROUP, L.P.	Senior subordinated debt	Consumer products & retail	11.00%	2/1/2023	10,100,000	9,938,559	9,898,000
	3.88% membership interest		—	—	—	2,500,000	2,500,000
AMERICAN NUTS OPERATIONS LLC ¹³	First Lien	Food, agriculture and beverage	L+8.50% (Floor 1.00%)/Q, Current	4/10/2023	17,412,500	17,103,748	16,872,713
						12,438,559	12,398,000

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	Coupon 10.90%				
	L+8.50%				
First Lien - Term Loan C ¹⁰	(Floor 1.00%)/Q, Current Coupon 11.31%	4/10/2023	1,750,000	1,721,676	1,695,750
3,000,000 units of Class A common stock ⁹	—	—	—	3,000,000	1,683,000
				21,825,424	20,251,463

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CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

December 31, 2018

Portfolio Company ¹	Type of Investment ^{2, 15}	Industry	Current Interest Rate ³	Maturity	Principal ⁴	Fair Value ⁴
AMERICAN TELECONFERENCING SERVICES, LTD.	First Lien	Telecommunications	L+6.50% (Floor 1.00%)/Q, Current Coupon 9.09%	12/8/2021	6,111,670	5,410,249
	Second Lien		L+9.50% (Floor 1.00%)/Q, Current Coupon 11.92%	6/6/2022	2,005,795	1,526,497
					7,951,667	529,949
AMWARE FULFILLMENT LLC	First Lien	Distribution	L+9.50% (Floor 1.00%)/M, Current Coupon 12.31%	12/31/2020	12,934,187	12,517,010
ASC ORTHO MANAGEMENT COMPANY, LLC ¹³	First Lien	Healthcare services	L+7.50% (Floor 1.00%)/Q, Current Coupon 9.90%	8/31/2023	9,319,688	8,928,212
	Second Lien		13.25% PIK	12/1/2023	3,142,306	2,836,835
	Revolving Loan ¹⁰	L+7.50% (Floor 1.00%)	8/31/2023	—	(27,979)	—
	2,042 Common Units ⁹	—	—	—	—	750,000
					12,933,748	12,007,047
BINSWANGER HOLDING CORP.	First Lien	Distribution	L+8.00% (Floor 1.00%)/M, Current Coupon 10.81%	3/9/2022	12,231,706	12,008,144
	900,000 shares of common stock		—	—	—	900,000
					12,962,760	13,011,144
BLASCHAK COAL CORP.	Second Lien ¹⁷	Commodities & mining	L+10.00%/Q, 1.00% PIK, Current Coupon 13.40%	7/30/2023	8,514,875	8,248,330
CALIFORNIA PIZZA KITCHEN, INC.	First Lien	Restaurants	L+6.00% (Floor 1.00%)/M, Current Coupon 8.53%	8/23/2022	4,887,505	4,935,094

CAPITAL PAWN HOLDINGS, LLC	First Lien	Consumer products & retail	L+9.50%/Q, Current Coupon 11.90%	7/8/2020	11,447,759	11,676,591
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CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

December 31, 2018

Portfolio Company ¹	Type of Investment ^{2, 15}	Industry	Current Interest Rate ³	Maturity	Principal Cost	Fair Value ⁴	
CLICKBOOTH.COM, LLC	First Lien	Media, marketing & entertainment	L+8.50% (Floor 1.00%)/Q, Current Coupon 10.90%	12/5/2022	17,062,500	17,631,938	
	Revolving Loan ¹⁰		L+8.50% (Floor 1.00%)	12/5/2022	—	15,706	16,761,938
DANFORTH ADVISORS, LLC ¹³	First Lien	Business services	L+7.25% (Floor 2.00%)/Q, Current Coupon 9.63%	9/28/2023	7,250,000	10,870,340	
	Revolving Loan ¹⁰		L+7.25% (Floor 2.00%)	9/28/2023	—	18,959	—
	875 Class A equity units ⁹		—	—	—	875,000	875,000
DELPHI INTERMEDIATE HEALTHCO, LLC	First Lien	Healthcare services	L+7.50% (Floor 1.00%)/Q, Current Coupon 10.04%	10/3/2022	7,265,622	10,971,203	
	First Lien		L+7.50% (Floor 1.00%)/Q, Current Coupon 10.19%	10/3/2022	4,906,258	6,293,125	12,070,264
DIGITAL RIVER, INC.	First Lien	Software & IT services	L+6.00% (Floor 1.00%)/Q, Current Coupon 8.78%	2/12/2021	6,285,404	7,051,222	
DUNN PAPER, INC.	Second Lien	Paper & forest products	L+8.75% (Floor 1.00%)/M, Current Coupon 11.27%	8/26/2023	3,000,000	2,955,080	
ELITE SEM, INC. ⁸	First Lien	Media, marketing & entertainment	L+8.53% (Floor 1.00%)/M, Current Coupon 11.27%	2/1/2022	14,000,000	13,002,042	
	1,443 Preferred units; 1,443 Class A Common units		12% PIK	—	—	2,008,134	2,462,000
						15,710,173	

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CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

December 31, 2018

Portfolio Company ¹	Type of Investment ^{2, 15}	Industry	Current Interest Rate ³	Maturity	Principal Cost	Fair Value ⁴
ENVIRONMENTAL PEST SERVICE MANAGEMENT COMPANY, LLC	First Lien	Consumer services	L+7.25%/Q, Current Coupon 9.65%	6/22/2023	16,209,357,949,546	1176,956
	Delayed Draw Term Loan ¹⁰		L+7.25%/Q, Current Coupon 9.94%	6/22/2023	5,150,579,491,191	1140,278
					20,998,213	217,234
FAST SANDWICH, LLC	First Lien	Restaurants	L+9.00% (Floor 1.00%)/Q, Current Coupon 11.40%	5/23/2023	3,258,750,009,380	203,351
	Revolving Loan ¹⁰		L+9.00% (Floor 1.00%)	—	—	60,671—
					3,148,709	203,351
LGM PHARMA, LLC ¹³	First Lien	Healthcare products	L+8.50% (Floor 1.00%)/M, Current Coupon 10.85%	11/15/2022	9,900,000,038,800	900,000
	Delayed Draw Term Loan ¹⁰		L+8.50% (Floor 1.00%)/M, Current Coupon 10.85%	11/15/2022	1,789,000,072,948	789,000
	110,000 units of Class A common stock ⁹		—	—	—	1,100,000
					12,611,728	10,000
LIGHTING RETROFIT INTERNATIONAL, LLC	First Lien	Environmental services	L+9.25% (Floor 1.00%)/Q, Current Coupon 12.05%	6/30/2022	13,875,000,060,096	583,625
	396,825 shares of Series B preferred stock; 25,603 shares of Series C preferred stock		—	—	—	525,603
					14,285,603	94,625
RESEARCH NOW GROUP, INC.	Second Lien	Business services	L+9.50% (Floor 1.00%)/M, Current Coupon 12.02%	12/20/2025	10,500,000,245	10,237,500
	First Lien			5/5/2022	6,937,500,887,467	937,500

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JVMC HOLDINGS CORP. 14		Financial services	L+8.02% (Floor 1.00%)/M, Current Coupon 10.54%				
TAX ADVISORS GROUP, LLC ¹³	143.3 Class A units ⁹	Financial services	—	—	—	541,176	645,000

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CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

December 31, 2018

Portfolio Company ¹	Type of Investment ^{2, 15}	Industry	Current Interest Rate ³ L+10.00% (Floor 1.00%)/M, Current Coupon 12.74%	Maturity	Principal Cost	Fair Value ⁴
VISTAR MEDIA INC.	First Lien	Media, marketing & entertainment		2/16/2022	7,975,000	8,054,750
	Warrants (Expiration - February 17, 2027)		—	—	886,000	2,378,000
					8,297,290	10,432,750
Total Non-control/Non-affiliate Investments					\$285,697,812	\$287,246,328
Affiliate Investments ⁶						
CHANDLER SIGNS, LLC ¹³	Senior subordinated debt	Business services	12.00% / 1.00% PIK	7/4/2021	4,545,887	\$4,361,732
	1,500,000 units of Class A-1 common stock ⁹		—	—	1,500,000	1,274,000
					5,996,603	5,635,732
DYNAMIC COMMUNITIES, LLC ¹³	First Lien	Business services	L+8.00% (Floor 1.00%)/M, Current Coupon 10.80%	7/17/2023	11,130,000	10,996,440
	Revolving Loan ¹⁰		L+8.00% (Floor 1.00%)	7/17/2023	— (4,540)	—
	2,000,000 Preferred Units ⁹		—	—	2,000,000	2,849,000
					12,919,155	13,845,440

Table of ContentsCAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

December 31, 2018

Portfolio Company ¹	Type of Investment ^{2, 15}	Industry	Current Interest Rate ³	Maturity	Principal ⁶	Cost	Fair Value ⁴
ITA HOLDINGS GROUP, LLC ¹³	First Lien	Transportation & logistics	L+9.00% (Floor 1.00%)/Q, Current Coupon 11.40%	2/14/2023	9,321,871	1,604,940	1,060,863
	First Lien - Term Loan B		L+9.00% (Floor 1.00%)/Q, Current Coupon 11.40%	2/14/2023	1,975,000	939,146	1,970,000
	Revolving Loan ¹⁰		L+9.00% (Floor 1.00%)/Q, Current Coupon 11.26%	2/14/2023	2,550,000	507,117	1,748,600
	Delayed Draw Term Loan		L+9.00% (Floor 1.00%)/Q, Current Coupon 11.40%	2/14/2023	1,481,254	453,900	1,439,775
	9.25% Class A Membership Interest ⁹		—	—	—	1,500,000	279,000
							16,560,507
ROSELAND MANAGEMENT, LLC	First Lien	Healthcare services	L+7.00% (Floor 2.00%)/Q, Current Coupon 9.59%	11/9/2023	10,500,000	320,513	10,320,533
	Revolving Loan ¹⁰		L+7.00% (Floor 2.00%)	11/9/2023	—	33,984	—
	10,000 Class A Units		—	—	—	1,000,000	—
							11,286,549
SIMR, LLC	First Lien	Healthcare services	L+9.00% (Floor 2.00%)/M, Current Coupon 11.74%	9/7/2023	11,688,000	467,592	11,254,744
	5,724,000 Class B Common Units		—	—	—	5,724,000	—
							17,191,592

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CONSOLIDATED SCHEDULE OF INVESTMENTS

(Unaudited)

December 31, 2018

Portfolio Company ¹	Type of Investment ^{2, 15}	Industry	Current Interest Rate ³	Maturity	Principal	Cost	Fair Value ⁴
ZENFOLIO INC. ¹⁶	First Lien	Business services	L+11.00% (Floor 1.00%)/Q, Current Coupon 13.40%	7/17/2022	13,331,250	13,395,556	12,638,025
	Revolving Loan ¹⁰		L+11.00% (Floor 1.00%)	7/17/2022	—	(14,162)	—
	190 shares of common stock		—	—	—	1,900,000	976,000
						15,025,394	13,614,025
Total Affiliate Investments Control Investments ⁷						\$78,979,890	\$77,865,412
I-45 SLF LLC ^{9, 10, 11}	80% LLC equity interest	Multi-sector holdings	—	—	—	\$64,800,000	\$63,116,838
MEDIA RECOVERY, INC. DBA SPOTSEE HOLDINGS ¹¹	800,000 shares of Series A convertible preferred stock	Industrial products	—	—	—	800,000	7,263,232
	4,000,002 shares of common stock		—	—	—	4,615,000	41,899,768
						5,415,000	49,163,000
PRISM SPECTRUM HOLDINGS, LLC ¹³	First Lien	Environmental services	L+9.50% (Floor 2.25%)/M, Current Coupon 12.24%	2/6/2023	13,461,430	13,174,833	13,313,404
	96,498.32 Class A units ⁹		—	—	—	6,538,522	6,035,000
						19,756,005	19,348,404
Total Control Investments						\$89,971,005	\$131,628,242

TOTAL INVESTMENTS ¹²	\$454,648,707	\$496,739,982
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¹ All debt investments are income-producing, unless otherwise noted. Equity investments are non-income producing, unless otherwise noted.

² All of the Company's investments, unless otherwise noted, are encumbered as security for the Company's senior secured credit facility.

The majority of investments bear interest at a rate that may be determined by reference to London Interbank Offered Rate ("LIBOR" or "L") or Prime ("P") and reset daily (D), monthly (M), quarterly (Q), or semiannually (S). For each the

³ Company has provided the spread over LIBOR or Prime and the current contractual interest rate in effect at December 31, 2018. Certain investments are subject to a LIBOR or Prime interest rate floor. Certain investments, as noted, accrue payment-in-kind ("PIK") interest.

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4 The Company's investment portfolio is comprised entirely of debt and equity securities of privately held companies for which quoted prices falling within the categories of Level 1 and Level 2 inputs are not available. Therefore, the Company values all of its portfolio investments at fair value, as determined in good faith by the Board of Directors, using significant unobservable Level 3 inputs. Refer to Note 4 for further discussion.

5 Non-Control/Non-Affiliate investments are generally defined by the Investment Company Act of 1940 (the "1940 Act") as investments that are neither control investments nor affiliate investments. At December 31, 2018, approximately 57.8% of the Company's investment assets were non-control/non-affiliate investments. The fair value of these investments as a percent of net assets is 90.4%.

6 Affiliate investments are generally defined by the 1940 Act as investments in which between 5% and 25% of the voting securities are owned and the investments are not classified as control investments. At December 31, 2018, approximately 15.7% of the Company's investment assets were affiliate investments. The fair value of these investments as a percent of net assets is 24.5%.

7 Control investments are generally defined by the 1940 Act as investments in which more than 25% of the voting securities are owned. At December 31, 2018, approximately 26.5% of the Company's investment assets were control investments. The fair value of these investments as a percent of net assets is 41.4%.

8 The investment is structured as a first lien last out term loan.

9 Indicates assets that are considered "non-qualifying assets" under section 55(a) of the 1940 Act. Qualifying assets must represent at least 70% of total assets at the time of acquisition of any additional non-qualifying assets. As of December 31, 2018, approximately 16.0% of the Company's investment assets are non-qualifying assets.

10 The investment has an unfunded commitment as of December 31, 2018. Refer to Note 11 - Commitments and Contingencies for further discussion.

11 Income producing through dividends or distributions.

12 As of December 31, 2018, the cumulative gross unrealized appreciation for federal income tax purposes is approximately \$50.9 million; cumulative gross unrealized depreciation for federal income tax purposes is \$9.0 million. Cumulative net unrealized appreciation is \$41.9 million, based on a tax cost of \$454.9 million.

13 ASC Ortho Management Company, LLC common units, Danforth Advisors, LLC common units, American Nuts Operations LLC Class A common stock, LGM Pharma, LLC Class A common stock, Tax Advisors Group, LLC Class A units, Chandler Signs, LP Class A-1 common stock, Dynamic Communities, LLC Preferred units, ITA Holdings Group, LLC membership interest, and Prism Spectrum Holdings LLC Class A units are held through a wholly-owned taxable subsidiary.

14 The investment is structured as a first lien first out term loan.

15 The Company generally acquires its investments in private transactions exempt from registration under the Securities Act of 1933, as amended (the "Securities Act"). These investments are generally subject to certain limitations on resale, and may be deemed "restricted securities" under the Securities Act.

16 As of December 31, 2018, the investment is paying default interest at a rate of 2.0% per annum.

17 The investment is structured as a split lien term loan, which provides the Company with a first lien priority on certain assets of the obligor and a second lien priority on different assets of the obligor.

18 Investment was on non-accrual status as of December 31, 2018, meaning the Company has ceased to recognize interest income on the investment.

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, 2018

Portfolio Company ¹	Type of Investment ²	Industry	Current Interest Rate ³	Maturity	Principal	Cost	Fair Value ⁴
Non-control/Non-affiliate Investments ⁵							
AAC HOLDINGS, INC.	First Lien	Healthcare services	L+6.75% (Floor 1.00%), Current Coupon 8.52%	6/30/2023	\$9,321,875	\$9,110,902	\$9,485,008
AG KINGS HOLDINGS INC. ⁸	First Lien	Food, agriculture & beverage	L+9.40% (Floor 1.00%), Current Coupon 11.21%	8/8/2021	9,650,000	9,507,562	9,437,700
ALLIANCE SPORTS GROUP, L.P.	Senior subordinated debt	Consumer products & retail	11.00%	2/1/2023	10,100,000	9,916,216	9,807,100
	membership interest		—	—	—	2,500,000	1,996,000
						12,416,216	11,803,100
AMERICAN TELECONFERENCING SERVICES, LTD.	First Lien	Telecommunications	L+6.50% (Floor 1.00%), Current Coupon 8.29%	12/8/2021	6,378,173	6,238,734	6,376,578
	Second Lien		L+9.50% (Floor 1.00%), Current Coupon 11.20%	6/6/2022	2,005,714	1,941,047	1,918,806
						8,179,781	8,295,384
AMWARE FULFILLMENT LLC ¹⁷	First Lien	Distribution	L+12.00% (Floor 1.00%), Current Coupon 14.02%	5/21/2019	13,478,333	13,284,488	12,939,200
	First Lien	Distribution		3/9/2022	13,036,418	12,817,614	12,899,536

BINSWANGER HOLDING CORP.			L+8.00% (Floor 1.00%), Current Coupon 10.02%					
	900,000 shares of common stock			—	—	—	900,000	874,000
							13,717,614	13,773,536
CALIFORNIA PIZZA KITCHEN, INC.	First Lien	Restaurants	L+6.00% (Floor 1.00%), Current Coupon 7.88%	8/23/2022	4,925,000	4,886,550	4,836,350	
CAPITAL PAWN HOLDINGS, LLC	First Lien	Consumer products & retail	L+9.50%, Current Coupon 11.19%	7/8/2020	12,922,365	12,669,652	12,767,297	

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2018

Portfolio Company ¹	Type of Investment ²	Industry	Current Interest Rate ³	Maturity	Principal	Cost	Fair Value ⁴
CLICKBOOTH.COM, LLC	First Lien	Media, marketing & entertainment	L+8.50% (Floor 1.00%), Current Coupon 10.19%	12/5/2022	17,390,625	15,608	14,797
	Revolving Loan ¹⁵		L+8.50% (Floor 1.00%)	12/5/2022	—	(18,719)	—
DEEPWATER CORROSION SERVICES, INC.	127,004 shares of Series A convertible preferred stock	Energy services (upstream)	—	—	—	8,000,000	629,000
DELPHI INTERMEDIATE HEALTHCO, LLC	First Lien	Healthcare services	L+7.50% (Floor 1.00%), Current Coupon 9.27%	10/3/2022	7,406,250	3,368	2,653
DIGITAL RIVER, INC.	First Lien	Software & IT services	L+6.50% (Floor 1.00%), Current Coupon 8.61%	2/12/2021	6,285,463	3,273,465	2,854,443
DUNN PAPER, INC.	Second Lien	Paper & forest products	L+8.75% (Floor 1.00%), Current Coupon 10.63%	8/26/2023	3,000,000	1,949,631	1,000,000
LGM PHARMA, LLC ¹³	First Lien	Healthcare products	L+8.50% (Floor 1.00%), Current Coupon 10.17%	11/15/2022	9,975,000	7,874,481	5,050
	Delayed Draw Term Loan ¹⁸		L+8.50% (Floor 1.00%), Current Coupon 10.29%	11/15/2022	1,300,000	74,815	297,400
	110,000 units of Class A common stock ⁹		—	—	—	1,100,000	100,000
LIGHTING RETROFIT INTERNATIONAL, LLC	First Lien	Environmental services	L+9.25% (Floor 1.00%), Current Coupon	6/30/2022	14,625,000	1,487,144	361,750

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			10.94%				
		396,825 shares of Series B preferred stock		—	—	—	500,000,000
							14,987,147,375
PRE-PAID LEGAL SERVICES, INC.	Second Lien	Consumer services	L+9.00% (Floor 1.25%), Current Coupon 10.88%	7/1/2020	5,000,000	1,967,663	10,000,000
RESEARCH NOW GROUP, INC.	Second Lien	Business services	L+9.50% (Floor 1.00%), Current Coupon 11.28%	12/20/2025	10,500,000	1,078,996	17,500,000

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2018

Portfolio Company ¹	Type of Investment ²	Industry	Current Interest Rate ³	Maturity	Principal	Fair Value ⁴
RESTAURANT TECHNOLOGIES, INC.	Second Lien	Business services	L+8.75% (Floor 1.00%), Current Coupon 10.69%	11/23/2023	3,500,000	3,493,000
JVMC HOLDINGS CORP. ¹⁴	First Lien	Financial services	L+8.02% (Floor 1.00%), Current Coupon 9.90%	5/5/2022	7,218,756	7,215,141
TAX ADVISORS GROUP, LLC ¹³	Senior subordinated debt	Financial services	10.00% / 2.00% PIK	12/23/2022	4,600,000	4,600,000
	143.3 Class A units ⁹		—	—	541,176	886,000
					5,059,060	5,486,000
VISTAR MEDIA INC.	First Lien	Media, marketing & entertainment	L+10.00% (Floor 1.00%), Current Coupon 12.02%	2/16/2022	8,112,500	8,193,625
	Warrants (Expiration - February 17, 2027)		—	—	886,000	1,682,000
					8,320,072	9,875,625
WASTEWATER SPECIALTIES, LLC	First Lien ¹⁶	Industrial services	L+12.25% (Floor 1.00%), Current Coupon 13.90%	4/18/2022	9,863,582	10,011,536
Total Non-control/Non-affiliate Investments					\$ 200,981,062	\$ 199,949,348
Affiliate Investments ⁶						
CHANDLER SIGNS, LLC ¹³	Senior subordinated	Business services	12.00% / 1.00% PIK	7/4/2021	4,511,259	\$ 4,375,922

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	debt						
	1,500,000						
	units of Class						
	A-1 common					1,500,000	1,934,000
	stock ⁹						
						5,950,704	6,309,922
			L+9.90%				
			(Floor				
			1.00%),				
ELITE SEM, INC. ⁸	First Lien	Media,	Current	2/1/2022	17,500,000	17,500,000	17,500,000
		marketing &	Coupon		17,500,000	17,500,000	17,500,000
		entertainment	12.10%				
	1,089						
	Preferred		12% PIK			1,235,651	1,879,000
	units						
						18,339,184	19,379,000

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CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2018

Portfolio Company ¹	Type of Investment ²	Industry	Current Interest Rate ³	Maturity	Principal	Cost	Fair Value ⁴
ITA HOLDINGS GROUP, LLC ¹³	First Lien	Transportation & logistics	L+8.50% (Floor 1.00%, Current Coupon 10.32%)	2/14/2023	9,500,000	9,313,995	9,313,995
	Revolving Loan ¹⁹		L+8.50% (Floor 1.00%)	2/14/2023	—	(9,748)	—
	Delayed Draw Term Loan		L+8.50% (Floor 1.00%, Current Coupon 10.32%)	2/14/2023	1,500,000	1,470,378	1,470,378
	9.25% Class A Membership Interest ⁹		—	—	—	1,500,000	1,500,000
						12,274,625	12,284,373
ZENFOLIO INC.	First Lien	Business services	L+9.00% (Floor 1.00%), Current Coupon 10.69%	7/17/2022	13,432,500	13,200,549	13,325,040
	Revolving Loan ¹⁵		L+9.00% (Floor 1.00%)	7/17/2022	—	(17,174)	—
	190 shares of common stock		—	—	—	1,900,000	1,900,000
						15,083,375	15,225,040
Total Affiliate Investments Control Investments ⁷						\$51,647,888	\$53,198,335
I-45 SLF LLC ^{9, 10, 11}	80% LLC equity interest	Multi-sector holdings	—	—	—	\$64,800,000	\$67,113,368
MEDIA RECOVERY, INC. ¹¹	800,000 shares of Series A convertible preferred stock	Industrial products	—	—	—	800,000	6,370,748
			—	—	—	4,615,000	36,751,252

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4,000,002 shares
of common stock

5,415,000 43,122,000

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CAPITAL SOUTHWEST CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2018

Portfolio Company ¹	Type of Investment ²	Industry	Current Interest Rate ³	Maturity	Principal	Fair Value ⁴
PRISM SPECTRUM HOLDINGS, LLC ¹³	First Lien	Environmental services	L+9.50% (Floor 2.25%), Current Coupon 11.75%	2/6/2023	4,325,247,522	4,240,522
	Revolving Loan ²⁰		L+9.50% (Floor 2.25%), Current Coupon 11.75%	2/6/2023	500,490,290	490,290
	57.25 Class A units ⁹		—	—	1,691,674 6,422,486	1,691,674 6,422,486
TITANLINER, INC.	1,189,609 shares of Series B convertible preferred stock	Energy services (upstream)	6% PIK	—	2,925,960	11,362,000
	339,277 shares of Series A convertible preferred stock		—	—	3,204,222	11,928,000
Total Control Investments					6,130,182 \$82,767,668	23,290,000 \$139,947,854
TOTAL INVESTMENTS ¹²					\$335,396,618	\$393,095,537

¹ All debt investments are income-producing, unless otherwise noted. Equity investments are non-income producing, unless otherwise noted.

² All of the Company's investments, unless otherwise noted, are encumbered as security for the Company's senior secured credit facility.

The majority of investments bear interest at a rate that may be determined by reference to London Interbank Offered Rate ("LIBOR" or "L") or Prime ("P") and reset daily, monthly, quarterly, or semiannually. For each the Company has provided the spread over LIBOR or Prime and the current contractual interest rate in effect at March 31, 2018.

³ Certain investments are subject to a LIBOR or Prime interest rate floor. Certain investments, as noted, accrue payment-in-kind ("PIK") interest.

Investments are carried at fair value in accordance with the Investment Company Act of 1940 (the "1940 Act") and Financial Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC") 820, Fair Value

⁴ Measurements and Disclosures. We determine in good faith the fair value of our Investment portfolio pursuant to a valuation policy in accordance with ASC 820 and a valuation process approved by our Board of Directors. See Note 4 to the consolidated financial statements.

⁵ Non-Control/Non-Affiliate investments are generally defined by the 1940 Act as investments that are neither control investments nor affiliate investments. At March 31, 2018, approximately 50.9% of the Company's investment assets

were non-control/non-affiliate investments. The fair value of these investments as a percent of net assets is 64.9%.

6 Affiliate investments are generally defined by the 1940 Act as investments in which between 5% and 25% of the voting securities are owned and the investments are not classified as control investments. At March 31, 2018, approximately 13.5% of the Company's investment assets were affiliate investments. The fair value of these investments as a percent of net assets is 17.3%.

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Control investments are generally defined by the 1940 Act as investments in which more than 25% of the voting securities are owned or maintains greater than 50% of the board representation. At March 31, 2018, approximately 35.6% of the Company's investment assets were control investments. The fair value of these investments as a percent of net assets is 45.4%.

⁸ The investment is structured as a first lien last out term loan.

Indicates assets that are considered "non-qualifying assets" under section 55(a) of the 1940 Act. Qualifying assets must represent at least 70% of total assets at the time of acquisition of any additional non-qualifying assets. As of March 31, 2018, approximately 18.0% of the Company's investment assets are non-qualifying assets.

⁹ The investment has approximately \$3.2 million unfunded commitment as of March 31, 2018.

¹⁰ Income producing through dividends or distributions.

As of March 31, 2018, the cumulative gross unrealized appreciation for federal income tax purposes is approximately \$62.4 million; cumulative gross unrealized depreciation for federal income tax purposes is \$4.9 million. Cumulative net unrealized appreciation is \$57.5 million, based on a tax cost of \$335.6 million.

ITA Holdings Group, LLC membership interest, LGM Pharma, LLC Class A common stock, Prism Spectrum Holdings LLC Class A units, Tax Advisors Group, LLC Class A units and Chandler Signs, LP Class A-1 common stock are held through a wholly-owned taxable subsidiary.

¹³ The investment is structured as a first lien first out term loan.

¹⁴ The investment has approximately \$2.0 million unfunded commitment as of March 31, 2018.

¹⁵ As of March 31, 2018, the investment is paying default interest at a rate of 3.0% per annum.

¹⁶ As of March 31, 2018, the investment is paying default interest at a rate of 2.5% per annum.

¹⁷ The investment has approximately \$0.9 million unfunded commitment as of March 31, 2018.

¹⁸ The investment has approximately \$2.0 million unfunded commitment as of March 31, 2018.

¹⁹ The investment has approximately \$1.5 million unfunded commitment as of March 31, 2018.

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

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Notes to Consolidated Financial Statements

1. ORGANIZATION AND BASIS OF PRESENTATION

References in this Quarterly Report on Form 10-Q to “we,” “our,” “us,” “CSWC,” or the “Company” refer to Capital Southwest Corporation, unless the context requires otherwise.

Organization

Capital Southwest Corporation is an internally managed investment company that specializes in providing customized financing to middle market companies in a broad range of industry segments located primarily in the United States. Our common stock currently trades on The Nasdaq Global Select Market under the ticker symbol “CSWC.”

CSWC was organized as a Texas corporation on April 19, 1961. On March 30, 1988, CSWC elected to be regulated as a business development company (“BDC”) under the 1940 Act. In order to comply with the 1940 Act requirements for a BDC, we must, among other things, generally invest at least 70% of our assets in eligible portfolio companies and limit the amount of leverage we incur.

We have elected, and intend to qualify annually, to be treated as a regulated investment company (“RIC”) under Subchapter M of the U.S. Internal Revenue Code of 1986, as amended (the “Code”). As such, we generally will not have to pay corporate-level U.S. federal income tax on any ordinary income or capital gains that we distribute to our shareholders as dividends. To continue to maintain our RIC treatment, we must meet specified source-of-income and asset diversification requirements and distribute annually at least 90% of our net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any. Depending on the level of taxable income earned in a tax year, we may choose to carry forward taxable income in excess of current year distributions into the next year and pay a 4% excise tax on such income. Any such carryover taxable income must be distributed through a dividend declared prior to filing the final tax return related to the year that generated such taxable income.

Capital Southwest Management Corporation (“CSMC”), a wholly-owned subsidiary of CSWC, is the management company for CSWC. 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.

CSWC also has a direct wholly-owned subsidiary that has been elected to be a taxable entity (the “Taxable Subsidiary”). The primary purpose of the Taxable Subsidiary is to permit CSWC to hold certain interests in portfolio companies that are organized as limited liability companies, or LLCs (or other forms of pass-through entities) and still allow us to satisfy the RIC tax requirement that at least 90% of our gross income for federal income tax purposes must consist of qualifying investment income. The Taxable Subsidiary is taxed at normal corporate tax rates based on its taxable income.

We focus on investing in companies with histories of generating revenues and positive cash flow, established market positions and proven management teams with strong operating discipline. We target senior debt, subordinated debt and equity investments in lower middle market (“LMM”) companies, as well as first and second lien syndicated loans in upper middle market (“UMM”) companies. Our target LMM companies typically have annual earnings before interest, taxes, depreciation and amortization (“EBITDA”) between \$3.0 million and \$15.0 million, and our LMM investments generally range in size from \$5.0 million to \$25.0 million. Our UMM investments generally include syndicated first and second lien loans in companies with EBITDA generally greater than \$50.0 million and typically range in size from \$5.0 million to \$15.0 million. We make available significant managerial assistance to the companies in which we invest as we believe that providing managerial assistance to an investee company is critical to its business

development activities.

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles in the United States of America (“U.S. GAAP”). We meet the definition of an investment company and follow the accounting and reporting guidance in the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 946 – Financial Services – Investment Companies (“ASC 946”). Under rules and regulations applicable to investment companies, we are generally precluded from consolidating any entity other than another investment

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company, subject to certain exceptions. One of the exceptions to this general principle occurs if the investment company has an investment in an operating company that provides services to the investment company. Accordingly, the consolidated financial statements include CSMC, our management company, and the Taxable Subsidiary.

The consolidated financial statements are presented in conformity with U.S. GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual consolidated financial statements prepared in accordance with U.S. GAAP are omitted. In the opinion of our management, the unaudited consolidated financial results included herein contain all adjustments, consisting solely of normal recurring accruals, considered necessary for the fair presentation of consolidated financial statements for the interim periods included herein. The results of operations for the three and nine months ended December 31, 2018 are not necessarily indicative of the operating results to be expected for the full fiscal year. Also, the unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal years ended March 31, 2018 and 2017. Consolidated financial statements prepared on a U.S. GAAP basis require management to make estimates and assumptions that affect the amounts and disclosures reported in the consolidated financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

Portfolio Investment Classification

We classify our investments in accordance with the requirements of the 1940 Act. Under the 1940 Act, "Control Investments" are generally defined as investments in which we own more than 25% of the voting securities; "Affiliate Investments" are generally defined as investments in which we own between 5% and 25% of the voting securities, and the investments are not classified as "Control Investments"; and "Non-Control/Non-Affiliate Investments" are generally defined as investments that are neither "Control Investments" nor "Affiliate Investments."

Under the 1940 Act, a BDC must meet certain requirements, including investing at least 70% of our assets in qualifying assets. As of December 31, 2018, the Company has 84.7% of our assets in qualifying assets. The principal categories of qualifying assets relevant to our business are:

- (1) Securities purchased in transactions not involving any public offering from the issuer of such securities, which issuer (subject to certain limited exceptions) is an eligible portfolio company, or from any person who is, or has been during the preceding 13 months, an affiliated person of an eligible portfolio company, or from any other person, subject to such rules as may be prescribed by the Securities and Exchange Commission ("SEC").
- (2) Securities of any eligible portfolio company that we control.
- (3) Securities purchased in a private transaction from a U.S. issuer that is not an investment company or from an affiliated person of the issuer, or in transactions incident thereto, if the issuer is in bankruptcy and subject to reorganization or if the issuer, immediately prior to the purchase of its securities was unable to meet its obligations as they came due without material assistance other than conventional lending or financing arrangements.
- (4) Securities of an eligible portfolio company purchased from any person in a private transaction if there is no readily available market for such securities and we already own 60% of the outstanding equity of the eligible portfolio company.
- (5) Securities received in exchange for or distributed on or with respect to securities described in (1) through (4) above, or pursuant to the exercise of warrants or rights relating to such securities.
- (6) Cash, cash equivalents, U.S. government securities or high-quality debt securities maturing in one year or less from the time of investment.

Additionally, in order to qualify as a RIC for U.S. federal income tax purposes, we must, among other things meet the following requirements:

- (1) Continue to maintain our election as a BDC under the 1940 Act at all times during each taxable year.

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- (2) Derive in each taxable year at least 90% of our gross income from dividends, interest, payments with respect to certain securities, loans, gains from the sale of stock or other securities, net income from certain "qualified publicly traded partnerships," or other income derived with respect to our business of investing in such stock or securities.
- (3) Diversify our holdings in accordance with two Diversification Requirements: (a) Diversify our holdings such that at the end of each quarter of the taxable year at least 50% of the value of our assets consists of cash, cash equivalents, U.S. Government securities, securities of other RICs, and such other securities if such other securities of any one issuer do not represent more than 5% of the value of our assets or more than 10% of the outstanding voting securities of the issuer; and (b) Diversify our holdings such that no more than 25% of the value of our assets is invested in the securities, other than U.S. government securities or securities of other RICs, (i) of one issuer, (ii) of two or more issuers that are controlled, as determined under applicable Code rules, by us and that are engaged in the same or similar or related trades or businesses or (iii) of certain "qualified publicly traded partnerships" (collectively, the "Diversification Requirements").

The two Diversification Requirements must be satisfied quarterly. If a RIC satisfies the Diversification Requirements for one quarter, and then, due solely to fluctuations in market value, fails to meet one of the Diversification Requirements in the next quarter, it retains RIC tax treatment. A RIC that fails to meet the Diversification Requirements as a result of a nonqualified acquisition may be subject to excess taxes unless the nonqualified acquisition is disposed of and the Diversification Requirements are satisfied within 30 days of the close of the quarter in which the Diversification Requirements are failed.

For the quarter ended December 31, 2018, we satisfied all RIC requirements and have 14.8% in nonqualified assets according to measurement criteria established in Section 851(d) of the Code.

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 We account for substantially all of our financial instruments at fair value in accordance with ASC Topic 820 – Fair Value Measurements and Disclosures ("ASC 820"). ASC 820 defines fair value, establishes a framework used to measure fair value and requires disclosures for fair value measurements, including the categorization of financial instruments into a three-level hierarchy based on the transparency of valuation inputs. ASC 820 requires disclosure of the fair value of financial instruments for which it is practical to estimate such value. We believe that the carrying amounts of our financial instruments such as cash, receivables and payables approximate the fair value of these items due to the short maturity of these instruments. This is considered a Level 1 valuation technique. The carrying value of our credit facility approximates fair value (Level 3 input). See Note 4 below for further discussion regarding the fair value measurements and hierarchy.

Investments Investments are stated at fair value and are reviewed and approved by our Board of Directors as described in the Notes to the Consolidated Schedule of Investments and Notes 3 and 4 below. Investments are recorded on a trade date basis.

Net Realized Gains or Losses and Net Unrealized Appreciation or Depreciation Realized gains or losses are measured by the difference between the net proceeds from the sale or redemption of an investment or a financial instrument and the cost basis of the investment or financial instrument, without regard to unrealized appreciation or depreciation previously recognized, and includes investments written-off during the period net of recoveries and realized gains or losses from in-kind redemptions. Net unrealized appreciation or depreciation reflects the net change in the fair value of the investment portfolio and financial instruments and the reclassification of any prior period unrealized appreciation or depreciation on exited investments and financial instruments to realized gains or losses.

Cash and Cash Equivalents Cash and cash equivalents, which consist of cash and highly liquid investments with an original maturity of three months or less at the date of purchase, are carried at cost, which approximates fair value. Cash may be held in a money market fund from time to time, which is a Level 1 security. Cash and cash equivalents includes deposits at financial institutions. We deposit our cash balances in financial institutions and, at times, such balances may be in excess of the Federal Deposit Insurance Corporation (“FDIC”) insurance limits. At December 31, 2018 and March 31,

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2018, cash balances totaling \$9.7 million and \$6.8 million, respectively, exceeded FDIC insurance limits, subjecting us to risk related to the uninsured balance. All of our cash deposits are held at large established high credit quality financial institutions and management believes that the risk of loss associated with any uninsured balances is remote.

Segment Information We operate and manage our business in a singular segment. As an investment company, we invest in portfolio companies in various industries and geographic areas as discussed in Note 3.

Consolidation As permitted under Regulation S-X and ASC 946, we generally do not consolidate our investment in a portfolio company other than an investment company subsidiary or a controlled operating company whose business consists of providing services to CSWC. Accordingly, we consolidated the results of CSWC's wholly-owned Taxable Subsidiary and CSWC's wholly-owned management company, CSMC. All intercompany balances have been eliminated upon consolidation.

Use of Estimates The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. We have identified investment valuation and revenue recognition as our most critical accounting 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 recognized on the date dividends are declared by the portfolio company or at the point an obligation exists for the portfolio company to make a distribution. Discounts/premiums received to par on loans purchased are capitalized and accreted or amortized into income over the life of the loan using the effective interest method. In accordance with our valuation policy, accrued interest and dividend income is evaluated quarterly 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 receivable, thereby placing the loan or debt security on non-accrual status, 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 its ability to service debt or other obligations, it will be restored to accrual basis. As of December 31, 2018, we had one investment on non-accrual status and past due on its contractual payment obligation. As of March 31, 2018, we did not have any investments on non-accrual status or past due on its contractual payment obligation.

To maintain RIC tax treatment, non-cash sources of income such as accretion of interest income may need to be paid out to shareholders in the form of distributions, even though CSWC may not have collected the interest income. For the three and nine months ended December 31, 2018, approximately 2.6% and 2.8%, respectively, of CSWC's total investment income was attributable to non-cash interest income for the accretion of discounts associated with debt investments, net of any premium reduction. For both the three and nine months ended December 31, 2017, approximately 2.3% of CSWC's total investment income was attributable to non-cash interest income for the accretion of discounts associated with debt investments, net of any premium reduction.

Payment-in-Kind Interest The Company currently holds, and expects to hold in the future, some investments in its portfolio that contain payment-in-kind ("PIK") interest and dividend provisions. The PIK interest and dividends, computed at the contractual rate specified in each loan agreement, are added to the principal balance of the loan, rather than being paid to the Company in cash, and are recorded as interest and dividend income. Thus, the actual collection of PIK interest and dividends may be deferred until the time of debt principal repayment or disposition of the equity investment. PIK interest and dividends, which are non-cash sources of income, are included in the Company's taxable income and therefore affect the amount the Company is required to distribute to stockholders to maintain its qualification as a RIC for U.S. federal income tax purposes, even though the Company has not yet collected the cash. Generally, when current cash interest and/or principal payments on a loan become past due, or if the Company

otherwise does not expect the borrower to be able to service its debt and other obligations, the Company will place the investment on non-accrual status and will generally cease recognizing PIK interest and dividend income on that loan for financial reporting purposes until all principal and interest have been brought current through payment or due to a restructuring such that the interest and dividend income is deemed to be collectible. The Company writes off any accrued and uncollected PIK interest and dividends when it is determined that the PIK interest and dividends are no longer collectible. As of December 31, 2018 and March 31, 2018, we have not written off any accrued and uncollected PIK interest and dividends. For the three and nine months ended December 31, 2018, approximately 1.5% and 1.0%, respectively, of CSWC's total investment income was attributable to

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non-cash PIK interest and dividend income. For the three and nine months ended December 31, 2017, approximately 0.8% and 0.9%, respectively, of CSWC's total investment income was attributable to non-cash PIK interest and dividend income.

Debt Issuance Costs Debt issuance costs include commitment fees and other costs related to CSWC's senior secured credit facility and its notes (as discussed further in Note 5). The costs in connection with the credit facility have been capitalized and are amortized into interest expense over the term of the credit facility. The costs in connection with the notes are a direct deduction from the related debt liability and amortized into interest expense over the term of the notes.

Federal Income Taxes CSWC has elected and intends to comply with the requirements of the Code necessary to qualify as a RIC. By meeting these requirements, we will not be subject to corporate federal income taxes on ordinary income or capital gains timely distributed to shareholders. In order to qualify as a RIC, the company is required to timely distribute to its shareholders at least 90% of investment company taxable income, as defined by the Code, 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.

Depending on the level of taxable income or capital gains earned in a tax year, we may choose to carry forward taxable income or capital gains in excess of current year distributions into the next year and pay a 4% excise tax on such income. Any such carryover taxable income or capital gains must be distributed through a dividend declared on or prior to the later of (1) the filing of the U.S. federal income tax return for the applicable fiscal year and (2) the fifteenth day of the ninth month following the close of the year in which such taxable income was generated.

In lieu of distributing our net capital gains for a year, we may decide to retain some or all of our net capital gains. We will be required to pay a 21% corporate-level federal income tax on any such retained net capital gains. We may elect to treat such retained capital gain as a deemed distribution to shareholders. Under such circumstances, shareholders will be required to include their share of such retained capital gain in income, but will receive a credit for the amount of corporate-level U.S. federal income tax paid with respect to their shares. As an investment company that qualifies as a RIC, 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 net capital gains actually distributed to shareholders and properly reported by us as capital gain dividends are generally taxable to the shareholders as long-term capital gains. See Note 6 for further discussion.

CSMC, a wholly-owned subsidiary of CSWC, and the Taxable Subsidiary are not RICs and are required to pay taxes at the corporate rate of 21% as of December 31, 2018. For tax purposes, CSMC and the Taxable Subsidiary have elected to be treated as taxable entities, and therefore are not consolidated for tax purposes and are taxed at normal corporate tax rates based on taxable income and, as a result of their activities, may generate income tax expense or benefit. The taxable income, or loss, of each of CSMC and the Taxable Subsidiary may differ from its book income, or loss, due to temporary book and tax timing differences and permanent differences. This income tax expense, or benefit, if any, and the related tax assets and liabilities, are reflected in our consolidated financial statements.

Management evaluates tax positions taken or expected to be taken in the course of preparing the Company's consolidated financial statements to determine whether the tax positions are "more-likely-than-not" to be sustained by the applicable tax authority. Tax positions with respect to tax at the CSWC level not deemed to meet the "more-likely-than-not" threshold would be recorded as an expense in the current year. Management's conclusions regarding tax positions will be subject to review and may be adjusted at a later date based on factors including, but not limited to, on-going analyses of tax laws, regulations and interpretations thereof. The Company has concluded that it

does not have any uncertain tax positions that meet the recognition of measurement criteria of ASC 740, Income Taxes, ("ASC 740") for the current period. Also, we account for interest and, if applicable, penalties for any uncertain tax positions as a component of income tax expense. No interest or penalties expense was recorded during the three and nine months ended December 31, 2018 and 2017.

Deferred Taxes Deferred tax assets and liabilities are recorded for losses or income at our taxable subsidiaries using statutory tax rates. A valuation allowance is provided against deferred tax assets when it is more likely than not that some portion or all of the deferred tax asset will not be realized. ASC 740 requires the effects of changes in tax rates and laws on deferred tax balances to be recognized in the period in which the legislation was enacted. See Note 6 for further discussion.

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Stock-Based Compensation We account for our stock-based compensation using the fair value method, as prescribed by ASC Topic 718, Compensation – Stock Compensation. Accordingly, we recognize stock-based compensation cost on a straight-line basis for all share-based payments 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 requisite service period of the related stock options. For restricted stock awards, we measure the grant date fair value based upon the market price of our common stock on the date of the grant. For restricted stock awards, we amortize this fair value to share-based compensation expense over the vesting term. We recognize forfeitures as they occur. We issue new shares upon the exercise of stock options. The unvested shares of restricted stock awarded pursuant to CSWC’s equity compensation plans are participating securities and are included in the basic and diluted earnings per share calculation. On October 26, 2010, we received an exemptive order from the SEC permitting us to issue restricted stock to our executive officers and certain key employees (the “Original Order”). On August 22, 2017, we received an exemptive order that supersedes the Original Order (the “Exemptive Order”) and, in addition to the relief granted under the Original Order, allows us to withhold shares to satisfy tax withholding obligations related to the vesting of restricted stock granted pursuant to the 2010 Restricted Stock Award Plan (the “2010 Plan”) and to pay the exercise price of options to purchase shares of our common stock granted pursuant to the 2009 Stock Incentive Plan (the “2009 Plan”).

At the three and nine months ended December 31, 2018, weighted-average basic shares were adjusted for the dilutive effect of stock-based awards of 2,568 and 2,422, respectively. At the three and nine months ended December 31, 2017, weighted-average basic shares were adjusted for the dilutive effect of stock-based awards of 71,631 and 67,427, respectively. For individual cash incentive awards, the option value of the individual cash incentive awards is calculated based on the changes in net asset value (“NAV”) of our Company. In connection with the Share Distribution, we entered into an Employee Matters Agreement (the “Employee Matters Agreement”) with CSW Industrials, Inc. (“CSWI”). Under the Employee Matters Agreement, the value of individual cash incentive awards was determined based upon the NAV of CSWC as of June 30, 2015. See Note 9 for further discussion.

Shareholder Distributions Distributions to common shareholders are recorded on the ex-dividend date. The amount of distributions, if any, is determined by the Board of Directors each quarter and is generally based upon the earnings estimated by management. Net realized capital gains, if any, are generally distributed, although the Company may decide to retain such capital gains for investment.

Presentation Presentation of certain amounts in the Consolidated Financial Statements for the prior year comparative consolidated financial statements is updated to conform to the current period presentation.

Recently Issued or Adopted Accounting Standards In February 2016, the FASB issued ASU 2016-02, Leases, which requires lessees to recognize on the balance sheet a right-of-use asset, representing its right to use the underlying asset for the lease term, and a lease liability for all leases with terms greater than 12 months. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing, and uncertainty of cash flows arising from leases. The standard requires the use of a modified retrospective transition approach, which includes a number of optional practical expedients that entities may elect to apply. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases, which affects narrow aspects of the guidance issued in the amendments in ASU 2016-02. The new guidance is effective for annual periods beginning after December 15, 2018, and interim periods therein. Early application is permitted. While we continue to assess the effect of adoption, we currently believe the single change relates to the recognition of a new right-of-use asset and lease liability on our consolidated balance sheet for our office space operating lease. We currently have one operating lease for office space and do not expect a significant change in our leasing activity between now and adoption.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 supersedes the revenue recognition requirements under SAC Topic 605, Revenue Recognition, and most

industry-specific guidance throughout the Industry Topics of the ASC. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. Under the new guidance, an entity is required to perform the following five steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The new guidance will

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significantly enhance comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. Additionally, the guidance requires improved disclosures as to the nature, amount, timing and uncertainty of revenue that is recognized. In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606)—Narrow-Scope Improvements and Practical Expedients. This ASU clarified guidance on assessing collectability, presenting sales tax, measuring noncash consideration, and certain transition matters. The new guidance is effective for the annual reporting period beginning after December 15, 2017, including interim periods within that reporting period. The Company adopted ASU 2014-09 effective April 1, 2018 and determined that its material financial contracts are excluded from the scope of ASU 2014-09. As a result of the scope exception for financial contracts, the Company's management has determined that there were no material changes to the recognition timing and classification of revenues and expenses; additionally, the adoption of ASU 2014-09 did not have a significant impact on pretax income or on the consolidated financial statement disclosures.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230), which is intended to reduce the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2017, and interim periods therein. The Company adopted ASU 2016-15 effective April 1, 2018 and the adoption did not have a material impact on the Company's consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement, which changes the fair value measurement disclosure requirements of ASC 820. The key provisions include new, eliminated and modified disclosure requirements. The new guidance is effective for fiscal years beginning after December 15, 2019, including interim periods therein. Early application is permitted. CSWC is currently evaluating the impact the adoption of this new accounting standard will have on its consolidated financial statements, but the impact of the adoption is not expected to be material.

In August 2018, the SEC issued the Final Rule Release No. 33-10532, Disclosure Update and Simplification, amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. The amendments are intended to facilitate the disclosure of information to investors and simplify compliance. The final rule was effective on November 5, 2018. The Company adopted these disclosure updates in the quarter ended December 31, 2018. The disclosure updates impacted the presentation of the consolidated financial statements by requiring the presentation of the total, rather than the components of the distributable earnings on the Consolidated Balance Sheet. Additionally, the Company updated the Consolidated Statement of Changes in Net Assets for the new interim reporting requirement to disclose the current and comparative year-to-date periods, including subtotals for each interim periods. Management does not consider the impact of these disclosure updates to be material to the consolidated financial statements.

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3. INVESTMENTS

The following table shows the composition of the investment portfolio, at fair value and cost (with corresponding percentage of total portfolio investments) as of December 31, 2018 and March 31, 2018:

	Percentage of Fair Value		Percentage of Total Portfolio Net Assets		Percentage of Cost		Percentage of Total Portfolio	
	(dollars in thousands)							
December 31, 2018:								
First lien loans ¹	\$300,305	60.5	%	94.5	%	\$300,797	66.2	%
Second lien loans ²	36,120	7.3		11.4		35,953	7.9	
Subordinated debt	14,260	2.9		4.5		14,435	3.2	
Preferred equity	16,585	3.3		5.2		7,834	1.7	
Common equity & warrants	66,353	13.3		20.9		30,830	6.8	
I-45 SLF LLC ²	63,117	12.7		19.9		64,800	14.2	
	\$496,740	100.0	%	156.4	%	\$454,649	100.0	%
March 31, 2018:								
First lien loans	\$197,110	50.1	%	63.9	%	\$194,820	58.1	%
Second lien loans	23,229	5.9		7.5		23,092	6.9	
Subordinated debt	18,783	4.8		6.1		18,885	5.6	
Preferred equity	36,545	9.3		11.9		16,666	5.0	
Common equity & warrants	50,315	12.8		16.3		17,134	5.1	
I-45 SLF LLC ³	67,113	17.1		21.8		64,800	19.3	
	\$393,095	100.0	%	127.5	%	\$335,397	100.0	%

¹ Included in first lien loans are loans structured as first lien last out loans. These loans may in certain cases be subordinated in payment priority to other senior secured lenders. As of December 31, 2018 and March 31, 2018, the fair value of the first lien last out loans are \$22.7 million and \$26.9 million, respectively.

² Included in second lien loans are loans structured as split lien term loans. These loans provide the Company with a first lien priority on certain assets of the obligor and a second lien priority on different assets of the obligor. As of December 31, 2018 and March 31, 2018, the fair value of the split lien term loans are \$18.3 million and \$0, respectively.

³ I-45 SLF LLC is a joint venture between CSWC and Main Street Capital. This entity primarily invests in syndicated senior secured loans to the UMM. The portfolio companies held by I-45 SLF LLC represent a diverse set of industry classifications, which are similar to those in which CSWC invests directly. See Note 14 for further discussion.

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The following tables show the composition of the investment portfolio by industry, at fair value and cost (with corresponding percentage of total portfolio investments) as of December 31, 2018 and March 31, 2018:

	Fair Value	Percentage of Total Portfolio		Percentage of Net Assets		Cost	Percentage of Total Portfolio	
	(dollars in thousands)							
December 31, 2018:								
I-45 SLF LLC ¹	\$63,117	12.7	%	19.9	%	\$64,800	14.3	%
Healthcare Services	62,649	12.6		19.7		62,444	13.7	
Media, Marketing, & Entertainment	59,126	11.9		18.6		54,721	12.0	
Business Services	51,342	10.3		16.2		51,730	11.4	