WATERSIDE CAPITAL CORP
Form 10-Q
February 14, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D) OF
THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED
DECEMBER 31, 2001

COMMISSION FILE NO.: 333-36709

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

VIRGINIA	54-1694665
(State of Incorporation)	(I.R.S. Employer Identification Number)
300 EAST MAIN STREET, SUITE 1380, NORFOLK, VIRGINIA	23510
(Address of principal executive office)	(Zip Code)

(757) 626-1111
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant 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 has been subject to the filing requirements for the past 90 days.
Yes [X]   No [_]

As of December 31, 2001, the registrant had issued and outstanding 1,581,430 shares of Common Stock, $1.00 par value.

WATERSIDE CAPITAL CORPORATION
FORM 10-Q

Table of Contents

		Page Number
PART I.	FINANCIAL INFORMATION	
Item 1.	Balance Sheets as of June 30, 2001 and December 31, 2001 (unaudited)	2
	Statements of Operations for the Three Months Ended and Six Month Ended December 31, 2000 and 2001 (unaudited)	3
	Statements of Changes in Stockholders' Equity for the Six Months Ended December 31, 2000 and 2001 (unaudited)	4
	Statements of Cash Flows for the Six Months Ended	

	December 31, 2000 and 2001 (unaudited)	5
	Notes to Financial Statements (unaudited)	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	12
PART II.	OTHER INFORMATION	
Item 4.	Submission of Matters to a Vote of Security Holders	16
SIGNATURES		17

1

WATERSIDE CAPITAL CORPORATION

Balance Sheets

June 30, 2001 and December 31, 2001

	June 30, 2001
Assets:	
Investments in portfolio companies, at fair value (note 2):	
Equity securities	$ 23,146,57
Debt securities	6,514,39
Options and warrants	4,025,94
Total investments, cost of $41,702,728 and $38,457,333 at June 30, 2001 and December 31, 2001, respectively	33,686,90
Current assets:	
Cash and cash equivalents	1,089,38
Current portion of dividends receivable	719,18
Interest receivable	101,30
Notes receivable	237,55
Refundable income taxes	533,22
Prepaid expenses	131,89
Other current assets	50,46
Total current assets	2,863,01
Dividends receivable, excluding current portion	278,58
Property and equipment, net	133,21
Deferred income taxes	550,00
Deferred financing costs, net	867,04

Total assets	$	38,378,75
Liabilities and Stockholders' Equity:		
Current liabilities:		
Accounts payable	$	85,22
Accrued interest		657,51
Accrued expenses		237,00
Deferred revenue		
Total current liabilities		979,74
Debentures payable		25,400,00
Total liabilities		26,379,74
Stockholders' equity:		
Common stock, $1 par value, 10,000,000 shares authorized, 1,581,430 issued and outstanding		1,581,43
Preferred stock, $1 par value, 25,000 shares authorized, no shares issued and outstanding		
Additional paid-in capital		14,618,71
Net unrealized depreciation on investments, net of income taxes		(7,464,34
Undistributed accumulated earnings		3,263,20
Total stockholders' equity		11,999,01
Commitments and contingencies		
Total liabilities and stockholders' equity	$	38,378,75
Net asset value per common share	$	7.5

See accompanying notes to financial statements.

WATERSIDE CAPITAL CORPORATION

Unaudited Statements of Operations

Three Months and Six Months ended December 31, 2000 and 2001

	Three Months ended December 31,		
	2000	2001	20

Operating income:			
Dividends	$ 645,559	$ 519,621	$ 1,35
Interest on debt securities	198,208	252,230	45
Interest on cash equivalents	1,642	9,146	
Fee and other income	93,181	71,795	20
Total operating income	938,590	852,792	2,03
Operating expenses:			
Salaries and benefits	204,836	176,306	45
Legal and accounting	52,100	44,100	9
Interest expense	494,644	526,995	95
Other operating expenses	82,180	68,209	18
Total operating expenses	833,760	815,610	1,69
Net operating income before income taxes	104,830	37,182	33
Income tax expense (benefit)	(170,000)	76,000	(31
Net operating income (loss)	274,830	(38,818)	65
Realized loss on investments, net of income tax expense of of $670,000 for the three months ended December 31, 2001 and $0 for the six months ended December 31, 2001	-	(222,778)	
Change in unrealized depreciation on investments, net of income tax expense (benefit) of $159,000 and $(302,000) for the three months ended December 31, 2000 and 2001, respectively, and $(274,000) and $512,000 for the six months ended December 31, 2000 and 2001, respectively	(1,369,473)	(1,706,162)	(2,07
Net decrease in stockholders' equity resulting from operations	$(1,094,643)	$ (1,967,758)	$ (1,42
Net decrease in stockholders' equity resulting from operations per share - basic and diluted	$ (0.69)	$ (1.24)	$

See accompanying notes to financial statements.

3

WATERSIDE CAPITAL CORPORATION

Unaudited Statements of Changes in Stockholders' Equity

Six Months ended December 31, 2000 and 2001

	Common stock Shares	Common stock Amount	Additional paid-in capital	Net unr deprec on inve
Balance at June 30, 2000	1,581,430	$ 1,581,430	$ 14,618,719	$ (1,21
Net operating income	-	-	-	
Change in net unrealized depreciation on investments, net of income taxes	-	-	-	(2,07
Balance at December 31, 2000	1,581,430	$ 1,581,430	$ 14,618,719	$ (3,29
Balance at June 30, 2001	1,581,430	$ 1,581,430	$ 14,618,719	$ (7,46
Net operating income	-	-	-	
Net realized loss on investments, net of income taxes	-	-	-	
Change in net unrealized depreciation on investments, net of income taxes	-	-	-	(37
Balance at December 31, 2001	1,581,430	$ 1,581,430	$ 14,618,719	$ (7,83

See accompanying notes to financial statements.

WATERSIDE CAPITAL CORPORATION

Unaudited Statements of Cash Flows

Six months ended December 31, 2000 and 2001

	20
Cash flows from operating activities:	
Net decrease in stockholders' equity resulting from operations	$ (1,4
Adjustments to reconcile net decrease in stockholders' equity resulting from operations to net cash provided by operating activities:	
Unrealized depreciation (appreciation) on investments	2,3
Realized loss on investments	
Accretion of preferred stock and loan investments	(2
Depreciation and amortization	
Deferred income tax expense (benefit)	(5
Changes in assets and liabilities increasing (decreasing) cash flows from operating activities:	

Dividends receivable	(1
Interest receivable	1
Refundable income taxes	3
Prepaid expenses and other current assets	
Accounts payable and accrued expenses	(
Deferred revenue	
Net cash provided by operating activities	4
Cash flows from investing activities:	
Investments in equity securities made	(7
Investments in debt securities made	(3,1
Principal collected on debt securities	1,7
Issuance of note receivable	
Proceeds from collection of note receivable	
Proceeds from sales of investments	
Acquisition of property and equipment	
Net cash provided by (used in) investing activities	(2,1
Cash flows from financing activities:	
Repayments of lines of credit	(1,4
Proceeds from debentures payable	3,1
Payment of deferred financing costs	(
Net cash provided by financing activities	1,5
Net increase (decrease) in cash and cash equivalents	(
Cash and cash equivalents, beginning of year	1
Cash and cash equivalents, end of period	$
Supplemental disclosure of cash flow information:	
Cash paid during the period for interest	$ 8
Cash paid during the period for income taxes	$

See accompanying notes to financial statements.

5

WATERSIDE CAPITAL CORPORATION

Notes to Financial Statements

June 30, 2001 and December 31, 2001 (Unaudited)

---

(1) Unaudited Interim Financial Information

In the opinion of management, the accompanying unaudited interim financial statements of Waterside Capital Corporation (the Company) are prepared in accordance with generally accepted accounting principles (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 financial statements prepared in accordance with GAAP are omitted. In the opinion of management, all adjustments, consisting of normal recurring accruals necessary for the fair presentation of financial statements for the interim period, have been included. The current period's results of operations are not necessarily indicative of results that ultimately may be achieved for the year. The interim financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in the Company's Form 10-K as of and for the year ended June 30, 2001, as filed with the Securities and Exchange Commission.

(2) Description of Business

The Company was incorporated in the Commonwealth of Virginia on July 13, 1993 and is a closed-end investment company licensed by the Small Business Administration (the SBA) as a Small Business Investment Corporation (SBIC). The Company makes equity investments in, and provides loans to, small business concerns to finance their growth, expansion and development. Under applicable SBA regulations, the Company is restricted to investing only in qualified small business concerns as contemplated by the Small Business Investment Act of 1958.

(3) Investments

Investments are carried at fair value, as determined by the Executive Committee of the Board of Directors. The Company, through its Board of Directors, has adopted the Model Valuation Policy, as published by the SBA, in Appendix III to Part 107 of Title 12 of the Code of Federal Regulations (the Policy). The Policy, among other things, presumes that loans and investments are acquired with the intent that they are to be held until maturity or disposed of in the ordinary course of business. Except for interest-bearing securities which are convertible into common stock, interest-bearing securities are valued at an amount not greater than cost, with unrealized depreciation being recognized when value is impaired. Equity securities of private companies are presumed to represent cost unless the performance of the portfolio company, positive or negative, indicates otherwise in accordance with the Policy guidelines. The fair value of equity securities of publicly traded companies are generally valued at their quoted market price discounted due to the investment size or market liquidity concerns and for the effect of restrictions on the sale of such securities.

Discounts can range from 0% to 4% for investment size and market liquidity concerns. Actual liquidity discounts in the portfolio at December 31, 2001 ranged from 15% to 40%. Discounts for restriction on the sale of the investments are 15% in accordance with the provisions of the Policy. The Company maintains custody of its investments as permitted by the Investment Company Act of 1940.

Investments consist primarily of preferred stock and debt securities obtained from portfolio companies in accordance with SBIC investment regulations. The financial statements include securities valued at $33,686,908 and $30,578,800 at June 30, 2001 and December 31, 2001 (87.8% and 83.0% of assets), respectively. The valuation process completed by management includes estimates made by management and the Executive Committee in the absence of readily ascertainable market values. These estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and those differences could be material.

7

WATERSIDE CAPITAL CORPORATION

Unaudited Schedule of Portfolio Investments

June 30, 2001 and December 31, 2001

The Company's investment portfolio at June 30, 2001 consisted of the following:

Equity Securities:	Number of shares	
Publicly Traded Companies:		
Avery Communications, Inc. Common Stock	245,000	$
Avery Communications, Inc. Common Stock (a)	190,167	
Avery Communications, Inc. Preferred Stock	1,250,000	
Netplex Group, Inc. Common Stock	66,400	
Netplex Group, Inc. Preferred Stock	1,500,000	
Tangent Solutions, Inc. (formerly Electronic Business Systems, Inc.) Common Stock (b)	500,000	
Tangent Solutions, Inc. (formerly Electronic Business Systems, Inc.) Common Stock (b)	1,423,821	
Primal Solutions, Inc. Common Stock	475,167	
Private Companies:		
Real Time Data Management Services, Inc. Preferred Stock	300	
Delta Education Systems, Inc. Preferred Stock	1,625	
Diversified Telecom, Inc. Preferred Stock (c)	1,500	
Crispies, Inc. Preferred Stock	400	
Triangle Biomedical Sciences Preferred Stock (c)	2,100	
JMS Worldwide, Inc. Preferred Stock	1,500	
EPM Development Systems Corp. Preferred Stock	1,500	
Fire King International Preferred Stock	2,000	
CCT Holdings (formerly SECC) Common Stock	840,000	
Eton Court Asset Management, Ltd. Preferred Stock	1,000	
Fairfax Publishing Co., Inc. Preferred Stock	1,100	

Digital Square, Inc. Convertible Preferred Stock	1,210,739
Answernet, Inc. Preferred Stock	550
Answernet, Inc. Preferred Stock	700
ISR Solutions, Inc. Preferred Stock	500
Capital Markets Group, Inc. Preferred Stock (c)	1,500
Jubilee Tech International, Inc. Convertible Preferred Stock (c)	2,200,000
VentureCom, Inc. Convertible Preferred Stock	278,164
Phoenix Fabrications, Inc. Preferred Stock (c)	400
AmeriComm Direct Marketing LLC Preferred Stock	27,696
Signius Investment Corporation Common Stock	2,059
Total equity securities	

Debt Securities:	Maturity	
Avery Communications, Inc. Convertible Note	12/10/02	$
Extraction Technologies of VA, LLC (c) (d)	7/22/03	
Extraction Technologies of VA, LLC (c) (d)	8/31/04	
Extraction Technologies of VA, LLC (c) (d)	11/2/04	
Extraction Technologies of VA, LLC (c) (d)	2/7/05	
Extraction Technologies of VA, LLC (c) (d)	2/25/05	
Extraction Technologies of VA, LLC (c) (d)	3/14/05	
JMS Worldwide, Inc.	7/31/03	
Diversified Telecom, Inc. (c)	Demand	
Diversified Telecom, Inc. (c)	5/19/02	
ISR Solutions, Inc.	6/30/04	
Fire King International	Demand	
TABET Manufacturing Co., Inc.	12/31/04	
National Assisted Living, LP (c)	12/31/04	
New Dominion Pictures LLC	4/30/06	

 (Continued)

WATERSIDE CAPITAL CORPORATION

Unaudited Schedule of Portfolio Investments

June 30, 2001 and December 31, 2001

	Maturity	
Mayfair Enterprises, Inc.	7/18/05	$
Digital Square, Inc. (c)	9/15/05	
Phoenix Fabrications, Inc.	9/8/05	
Kotarides Baking Co. of VA (c)	6/5/01	
Kotarides Baking Co. of VA	Demand	
AmeriComm Direct Marketing LLC	12/29/05	
Triangle Biomedical Sciences	12/8/01	
Tangent Solutions, Inc. (formerly Electronic Business Systems, Inc.) (b) (c)	-	

Total debt securities

Stock Options and Warrants:	Number of shares	Percentage ownership	
Publicy Traded Companies:			
Netplex Group, Inc. (a)	300,000	2.10	$
Tangent Solutions, Inc. (formerly Electronic Business Systems, Inc.) (a) (b)	98,000	0.63	
Private Companies:			
Real Time Data Management Services, Inc.	125	29.41	
Delta Education Systems, Inc.	639	39.00	
Diversified Telecom, Inc.	8,998	15.00	
Crispies, Inc.	524	6.37	
Triangle Biomedical Sciences	632,916	12.20	
Extraction Technologies of VA, LLC (d)	-	39.00	
JMS Worldwide, Inc.	199	5.00	
EPM Development Systems Corp.	87	8.00	
Fire King International	4	4.00	
CCT Holdings (formerly SECC)	150,000	3.15	
Eton Court Asset Management, Ltd.	14,943	13.00	
Fairfax Publishing Co., Inc.	1,026	20.30	
ISR Solutions, Inc.	588,334	5.90	
Digital Square, Inc.	150,000	-	
Answernet, Inc.	69,837	16.50	
TABET Manufacturing Co., Inc.	487,500	19.50	
National Assisted Living, LP	-	15.00	
Capital Markets Group, Inc.	2,294,118	15.00	
Jubilee Tech International, Inc.	400,000	1.60	
Signius Investment Corporation	12	11.67	
VentureCom, Inc.	38,943	0.37	
New Dominion Pictures LLC	-	9.00	
Mayfair Enterprises, Inc.	-	15.00	
Phoenix Fabrications, Inc.	-	25.00	
Kotarides Baking Co. of VA	-	13.75	
Total options and warrants			
Total investments			$

WATERSIDE CAPITAL CORPORATION

Unaudited Schedule of Portfolio Investments

June 30, 2001 and December 31, 2001

The Company's investment portfolio at December 31, 2001 consisted of the following:

Equity Securities:	Number of shares
Publicly Traded Companies:	
Avery Communications, Inc. Preferred Stock	1,250,000
Netplex Group, Inc. Common Stock	66,400
Tangent Solutions, Inc. (formerly Electronic Business Systems, Inc.) Common Stock (b)	500,000
Tangent Solutions, Inc. (formerly Electronic Business Systems, Inc.) Common Stock (b)	1,423,821
Primal Solutions, Inc. Common Stock	280,000
Private Companies:	
Real Time Data Management Services, Inc. Common Stock	125
Delta Education Systems, Inc. Preferred Stock	1,625
Diversified Telecom, Inc. Preferred Stock (c)	1,500
Crispies, Inc. Preferred Stock	400
Triangle Biomedical Sciences Preferred Stock (c)	2,200
EPM Development Systems Corp. Preferred Stock	1,500
Fire King International Preferred Stock	2,000
CCT Holdings (formerly SECC) Common Stock	840,000
Eton Court Asset Management, Ltd. Preferred Stock	1,000
Fairfax Publishing Co., Inc. Preferred Stock	600
Digital Square, Inc. Convertible Preferred Stock	1,210,739
Answernet, Inc. Preferred Stock	545
Answernet, Inc. Preferred Stock	700
Capital Markets Group, Inc. Preferred Stock (c)	1,500
Jubilee Tech International, Inc. Convertible Preferred Stock (c)	2,200,000
VentureCom, Inc. Convertible Preferred Stock	278,164
Phoenix Fabrications, Inc. Preferred Stock (c)	400
AmeriComm Direct Marketing LLC Preferred Stock	27,696
Signius Investment Corporation Common Stock	2,059
Netplex Systems, Inc. Preferred Stock	1,000,000
Total equity securities	

Debt Securities:	Maturity
Avery Communications, Inc. Convertible Note	12/31/06
Extraction Technologies of VA, LLC (c) (d)	7/22/03
Extraction Technologies of VA, LLC (c) (d)	8/31/04
Extraction Technologies of VA, LLC (c) (d)	11/2/04
Extraction Technologies of VA, LLC (c) (d)	2/7/05
Extraction Technologies of VA, LLC (c) (d)	2/25/05
Extraction Technologies of VA, LLC (c) (d)	3/14/05
JMS Worldwide, Inc. (c)	7/31/03
Diversified Telecom, Inc. (c)	Demand
Diversified Telecom, Inc. (c)	5/19/02
Fire King International	Demand
TABET Manufacturing Co., Inc.	12/31/04
National Assisted Living, LP (c)	12/31/04

New Dominion Pictures LLC	4/30/06
Mayfair Enterprises, Inc.	Demand
Digital Square, Inc. (c)	9/15/05
Phoenix Fabrications, Inc. (c)	9/8/05
AmeriComm Direct Marketing LLC	12/29/05

 (Continued)

WATERSIDE CAPITAL CORPORATION

Unaudited Schedule of Portfolio Investments

June 30, 2001 and December 31, 2001

	Maturity	Cost contri val
Triangle Biomedical Sciences	Demand	$ 18
Jubilee Tech International, Inc.	3/21/02	12
Netplex Group, Inc.	12/31/01	15
Netplex Group, Inc.	1/28/02	1,06
Eton Court Asset Management, Ltd.	5/18/04	50
Caldwell/VSR, Inc.	12/16/06	1,62
Total debt securities		12,99

Stock Options and Warrants:	Number of shares	Percentage ownership	Cost contri val
Private Companies:			
Delta Education Systems, Inc.	639	39.00	$ 4
Diversified Telecom, Inc.	8,998	15.00	
Crispies, Inc.	524	6.37	
Triangle Biomedical Sciences	632,916	12.20	17
Extraction Technologies of VA, LLC (d)	-	39.00	33
JMS Worldwide, Inc.	199	5.00	
EPM Development Systems Corp.	87	8.00	1
Fire King International	4	4.00	
Eton Court Asset Management, Ltd.	14,943	13.00	3
Fairfax Publishing Co., Inc.	1,026	20.30	12
ISR Solutions, Inc.	588,334	5.90	1
Digital Square, Inc.	150,000	-	7
Answernet, Inc.	69,837	16.50	26
TABET Manufacturing Co., Inc.	487,500	19.50	17
National Assisted Living, LP	-	15.00	66
Capital Markets Group, Inc.	2,294,118	15.00	
Jubilee Tech International, Inc.	400,000	1.60	24
Signius Investment Corporation	12	11.67	
VentureCom, Inc.	38,943	0.37	

New Dominion Pictures LLC	-	9.00	46
Phoenix Fabrications, Inc.	-	25.00	29
Caldwell/VSR, Inc.	-	5.75	9
Total options and warrants			3,02
Total investments			$ 38,45

(a) Rule 144A restricted securities.

(b) This entity filed Chapter 11 bankruptcy on September 1, 2000.

(c) Entity is in arrears with respect to dividend/interest payments.

(d) This entity filed Chapter 11 bankruptcy on December 26, 2000.

11

ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

. General

Waterside Capital Corporation ("Waterside" or the "Company") is a specialty finance company located in Norfolk, Virginia. The Company invests in equity and debt securities to finance the growth, expansion and modernization of small private businesses, primarily in the Mid-Atlantic Region. The Company was formed in 1993 as the Eastern Virginia Small Business Investment Corporation. Through June 30, 1996, the Company operated as a development stage company focused primarily on preparation to commence operation. The Company was licensed in 1996 by the Small Business Administration (SBA) as a Small Business Investment Company (SBIC) under the Small Business Investment Act of 1958. In October 1996 the Company made its first portfolio investment. In January 1998 the Company completed its Initial Public Offering (IPO) to raise additional equity to support its growth strategy.

The majority of the Company's operating income is derived from dividend and interest income on portfolio investments and application and processing fees related to investment originations. The remaining portion of the Company's operating income comes from interest earned on cash equivalents. The Company's operating expenses primarily consist of interest expense on borrowings to fund its portfolio growth and payroll and other expenses incidental to operations. Waterside currently has 6 full time employees.

. Results of Operations

Comparison of Three Months Ended December 31, 2001 and December 31, 2000

For the three months ended December 31, 2001, total operating income was $853,000 compared to $939,000 reported during the same period of 2000, a decrease of $86,000 or 9.2%. The decrease in operating income is primarily due to management's decision to discontinue the accrual of dividend and interest income on an increased number of investments which are not performing as expected. The Company's quarterly operating income for three months ended December 31, 2001 consisted of dividends of $520,000, interest on debt securities of $252,000, fee income of $72,000 and interest on cash equivalents of $9,000. For the comparable period of 2000 quarterly operating income consisted of dividends of $646,000, interest on debt securities of $198,000, fee income of $93,000 and interest on cash equivalents of $2,000.

Total operating expenses were $816,000 for the three months ended December 31, 2001, compared to $834,000 reported for the three months ended December 31, 2000. Total operating expenses for the three months ended December 31, 2001 consisted of interest expense of $527,000, salaries and benefits of $177,000, legal and accounting expenses of $44,000 and other operating expenses of $68,000. For the three months ended December 31, 2000 total operating expenses consisted of interest expense of $495,000, salaries and benefits of $205,000, legal and accounting expenses of $52,000 and other operating expenses of $82,000. The increase in interest expense for the quarter ended December 31, 2001, compared to the quarter ended December 31, 2000, is due to the increased borrowings necessary to fund the Company's investment portfolio. The decrease in salaries and benefits for the quarter ended December 31, 2001, compared to the quarter ended December 31, 2000, is due to the reduction in force of one Business Development Officer and one clerical position. The Company's net operating loss of $39,000 for the three months ended December 31, 2001 compared unfavorably to the $275,000 net operating income reported for the three months ended December 31, 2000.

The change in unrealized depreciation on investments of $2.0 million before tax benefit of $302,000 for the three months ended December 31, 2001 was due to the recognition of numerous gains and losses recognized during the quarter. The most significant gains recorded during the quarter were a $1.0 million unrealized gain recognized from the Delta Education Systems, Inc investment and a $750,000 unrealized gain on the ISR Solutions, Inc. investment both due to new significant outside investments. These gains were offset by write downs on two investments

12

consisting of $2.4 million on the JMS North America Inc. investment and $1.4 million on the Digital Square investment due to deteriorating financial condition of these investees. The change in unrealized depreciation on investments net of taxes of $1.4 million for the three months ended December 31, 2000 was primarily due to the write down of a portfolio company (Extraction Technologies of Virginia) that filed for bankruptcy protection under Chapter 11 of the US Bankruptcy Code in order to restructure contractual and debt obligations.

During the quarter ended December 31, 2001, the Company ceased recognizing deferred tax benefits associated with the generation of net operating losses from operations and its realized loss because management could no longer conclude that it is more likely than not that those benefits could be realized. Because the Company operates as a licensed SBIC, its dividend income is not taxable. As a result, it is unlikely that the Company will generate taxable income from operations in the foreseeable future. Unless the Company is able to generate significant realized gains on sales of investments, the benefits of tax losses from operations and any realized losses from settlement of investments are not likely to be realized. As a result, the Company has provided a valuation allowance against its deferred tax asset to reflect an amount that is more likely than not to be realized.

The net decrease in stockholders' equity resulting from operations of $1,968,000 for the three months ended December 31, 2001, or $1.24 per share, compared to a decrease of $1,095,000, or $.69 per share, for the three months ended December 31, 2000.

. Comparison of six months ended December 31, 2001 and December 31, 2000

For the six months ended December 31, 2001, total operating income was $2,035,000 which is consistent with the $2,032,000 reported for the six months ended December 31, 2000. The operating income reported for the six months ended December 31, 2001 consisted of dividends of $1,120,000, interest on debt securities of $658,000, fee income of $239,000, and interest on cash equivalents of $18,000. For the six months ended December 31, 2000, operating income consisted of dividends of $1,360,000, interest on debt securities of $459,000, fee income of $205,000, and interest on cash equivalents of $8,000.

Total operating expenses for the six months ended December 31, 2001 were $1,655,000, consisting of interest expense of $1,050,000, salaries and benefits of $369,000, legal and accounting expenses of $88,000 and other operating expenses of $148,000. These expenses compared to $1,695,000 for the six months ended December 31, 2000, consisting of interest expense of $958,000, salaries and benefits of $455,000, legal and accounting expenses of $95,000, and other operating expenses of $187,000. The increase in interest expense for the six months ended December 31, 2001, compared to December 31, 2000, is due to the increased borrowings necessary to fund the Company's investment portfolio. The decrease in salaries and benefits and other operating expenses when comparing the six months ended December 31, 2001 to 2000, is due to a combination of a reduction in force and reduced travel expense. As an SBIC the Company is regulated by the SBA and must operate within certain prescribed expense guidelines. At December 31, 2001, the Company is in compliance with the SBA guidelines for management expense.

For the six months ended December 31, 2001, net operating income before income taxes was $379,000 compared to the $337,000 reported for the six months ended December 31, 2000. Net operating income declined to $379,000 for the six months ended December 31, 2001 from the $656,000 reported for the six months ended December 31, 2000 due primarily to a valuation allowance recognized for deferred tax benefits associated with the generation of net operating losses from operations. The Company recognized $319,000 in income tax benefit for the six months ended December 31, 2000 compared to $0 for the six months ended December 31, 2001.

During the six months ended December 31, 2001, the Company realized a loss on investments of $1.3 million due primarily to the realization of the previously recorded unrealized loss related to Tangent Solutions, Inc. (Formerly named Electronic Business Systems, Inc. and Triangle Imaging Group, Inc.). The realization was due to a bankruptcy court ruling.

The change in unrealized depreciation on investments, net of income tax expense, of $375,000 for the six months ended December 31, 2001 was due to numerous gains and losses recognized on the company's investment portfolio.

The change in unrealized depreciation consisted of gains of $1.0 million on the Delta Education Systems, Inc. investment due to a new significant outside investment, $750,000 on the ISR Solutions, Inc. investment due to a new significant outside investment, $537,000 on the The Netplex Group, Inc. investment due to restructuring of the terms of the investment and a $1.9 million reclassification of unrealized depreciation related to Tangent

Solutions, Inc to a realized loss. These gains were offset by unrealized losses recognized of $2.4 million on the JMS North America Inc. investment and $1.4 million on the Digital Square investment due to the deteriorating financial condition of these investees. During the six months ended December 31, 2000 the Company recorded pretax unrealized depreciation in the fair value of its investments of $2.4 million, primarily due to the write down of two portfolio companies that each filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. The write downs were $1.2 million for Electronic Business Systems, Inc., and $1.1 million for Extraction Technologies of Virginia. In addition, during the six months ended December 31, 2000 the Company reduced its recognized tax benefit by $619,000 on the cumulative unrealized depreciation on investments due to uncertainty as to the realization of these associated tax benefits. As previously discussed in the three month comparison, the Company has ceased recognizing deferred tax benefits associated with the generation of net operating losses from operations and its realized loss.

The net decrease in stockholders' equity resulting from operations of $1.3 million for the six months ended December 31, 2001 or $.83 per share compared to a decrease of $1.4 million or $.90 per share for the comparable six months ended December 31, 2000.

. Financial Condition, Liquidity And Capital Resources

At December 31, 2001, the Company's investment portfolio totaled $30.6 million compared with the $33.7 million reported at June 30, 2001. For the six months ended December 31, 2001, the Company funded $2.7 million in new loans and investments and received proceeds from sales of investments and principal collected on debt securities of $4.8 million. For the comparable six months ended December 31, 2000, the Company funded $3.8 million in new investments and received $1.7 million in principal collected on debt securities.

Net asset value per common share declined to $6.76 per share at December 31, 2001, from $7.59 per share reported at June 30, 2001.

During the six months ended December 31, 2001, net cash provided by operating activities was $498,000 compared to the $466,000 provided during the six months ended December 31, 2000. Net cash provided by investing activities was $2,118,000 for the six months ended December 31, 2001 as compared to the $2,117,000 used in investing activities for the six months ended December 31, 2000. This fluctuation is primarily due to new investments made of $ 2.7 million and proceeds from sales of investments and principal collected on debt securities of $4.8 million for the six month ended December 31, 2001 compared to new investments made of $3.8 million and principal collected on debt securities of $1.7 million for the six months ended December 31, 2000. There were no cash flows provided by financing activities for the six months ended December 31, 2001, compared to the $1,573,000 provided during the six months ended December 31, 2000. The cash was provided by debenture borrowings from the SBA during the six months ended December 31, 2000, necessary to finance new investments. The cash received from the SBA was partially offset by repayments on the Company's lines of credit.

. Quantitative and Qualitative Disclosure About Market Risk

The Company's business activities contain elements of market risk. The Company considers the principal types of market risk to be: risk of lending and investing in small privately owned companies, valuation risk of portfolio, risk of illiquidity of portfolio investments and the competitive market for investment opportunities. The Company considers the management of risk essential to conducting its business and to maintaining profitability. Accordingly, the Company's risk management systems and procedures are designed to identify and analyze the Company's risks, to set appropriate policies and limits and to continually monitor these risks and limits by means of reliable administrative and information systems and other policies and programs.

The Company manages its market risk by maintaining a portfolio of investments that is diverse by industry, geographic area, size of individual investment and borrower. The Company is exposed to a degree of risk of public

market price fluctuations as three of the Company's thirty investments are in thinly traded, small public companies, whose stock prices have been volatile. The other twenty-seven investments are in private business enterprises. Since there is typically no public market for the equity interests of the small companies in which the Company invests, the valuation of the equity interests in the Company's portfolio of private business enterprises is based on estimates made by the Company's Executive Committee. In the absence of a readily ascertainable market value, the estimated value of the Company's portfolio of equity interests may differ significantly from the values that would be placed on the portfolio if a ready market for the equity interests existed. Any changes in estimated value are recorded in the Company's statement of operations as "Net unrealized gains (losses)." Each hypothetical 1% increase or decrease in value of the Company's portfolio of investments of $30.6 million at December 31, 2001, would have resulted in unrealized gains or losses and would have changed net increase in stockholders' equity resulting from operations for the quarter by $306,000.

The Company's sensitivity to changes in interest rates is regularly monitored and analyzed by measuring the characteristics of assets and liabilities. The Company utilizes various methods to assess interest rate risk in terms of the potential effect of interest income net of interest expense, the market value of net assets and the value at risk in an effort to ensure that the Company is insulated from any significant adverse effects from changes in interest rates. Based on the model used for the sensitivity of interest income net of interest expense, if the balance sheet were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical 100 basis point change in interest rates would have a negligible effect on the net increase in stockholders' equity resulting from operations over the next year. Although management believes that this measure is indicative of the Company's sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the balance sheet and other business developments that could affect operating results. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

. Forward-Looking Statements

Included in this report and other written and oral information by management from time to time, including reports to shareholders, quarterly and semi-annual shareholder letters, filings with the Securities and Exchange Commission, news releases and investor presentations, are forward-looking statements about business objectives and strategies, market potential, its available capital resources, including SBA leverage, the Company's ability to expand the geographic scope of its investments, the quality of the Company's due diligence efforts, its financing plans, its vendors, suppliers, and portfolio companies, future financial performance and other matters that reflect management's expectations as of the date made.

Except for historical information, all of the statements, expectations and assumptions contained in the foregoing are "forward-looking statements" (within the meaning of the Private Securities Litigation Reform Act of 1995) that involve a number of risks and uncertainties. When the Company used words such as "believes," "expects," "anticipates," "intends," "plans," "estimates," "should," "likely," or similar expressions, the Company is making a forward-looking statement. It is possible that the assumptions made by management - including, but not limited to, the average maturity of our investments, the potential to realize investment gains as these investments mature, investment opportunities, results, performance or expectations - may not materialize. Actual results may differ materially from those projected or implied in any forward-looking statements. In addition to the above factors, other important factors that may affect the Company's performance include: the risks associated with the performance of the Company's portfolio companies, dependencies on key employees, interest rates, the level of economic activity, and competition, as well as other risks described from time to time in the Company's filings with the Securities Exchange Commission, press releases, and other communications. The Company disclaims any intent or obligation to update these forward-looking statements, whether as a result of new information, future events, or otherwise.

15

PART II. OTHER INFORMATION:

ITEM 1. LEGAL PROCEEDINGS

The Company is not a party to any material legal proceedings.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The 2001 Annual Meeting of Shareholders of Waterside Capital Corporation was held on October, 29, 2001 to consider two matters of business. The matters brought before the shareholders and the voting results are as follows:

1. Election of Directors

	FOR	%	WITHHOLD	%
James E. Andrews	1,237,128	93.6	84,531	6.4
J. W. Whiting Chisman, Jr.	1,237,128	93.6	84,531	6.4
Eric L. Fox	1,239,248	93.8	82,411	6.2
Marvin S. Friedberg	1,237,128	93.6	84,531	6.4
Roger L. Frost	1,239,248	93.8	82,411	6.2
Ernest F. Hardee	1,237,128	93.6	84,531	6.4
Henry U. Harris, III	1,239,248	93.8	82,411	6.2

J. Alan Lindauer	1,236,339	93.5	85,320	6.5
Robert L. Low	1,239,248	93.8	82,411	6.2
Peter M. Meredith, Jr.	1,237,128	93.6	84,531	6.4
Charles H. Merriman, III	1,239,248	93.8	82,411	6.2
Augustus C. Miller	1,239,248	93.8	82,411	6.2
Juan M. Montero, II	1,237,128	93.6	84,531	6.4
R. Scott Morgan, Sr.	1,239,248	93.8	82,411	6.2
Richard G. Ornstein	1,237,017	93.6	84,642	6.4
Jordan E. Stone	1,239,248	93.8	82,411	6.2

2. Ratification of the appointment of KPMG LLP as independent auditors for 2002.

FOR	%	AGAINST	%	ABSTAIN	%
1,278,525	96.7	43,134	3.3	0	0.0

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Norfolk, Commonwealth of Virginia on the 12/th/ day of February 2002.

WATERSIDE CAPITAL CORPORATION

By /s/ J. Alan Lindauer

J. Alan Lindauer
President and Principal Executive Officer

By /s/ Gerald T. McDonald

Gerald T. McDonald
Principal Financial Officer