

Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

WATERSIDE CAPITAL CORP  
Form 10-Q  
May 15, 2001

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  
MARCH 31, 2001

COMMISSION FILE NO.: 333-36709  
-----

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

VIRGINIA (State of Incorporation) 54-1694665 (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 March 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, 2000 and March 31, 2001 (unaudited)	2
Statements of Operations for the Three Months and Nine Months Ended March 31, 2000 and 2001 (unaudited)	3
Statement of Changes in Stockholders' Equity for the Nine Months Ended March 31, 2000 and 2001 (unaudited)	4
Statements of Cash Flows for the Nine Months Ended March 31, 2000 and 2001 (unaudited)	5

## Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

Notes to Financial Statements (unaudited)		6
ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations		13
PART II. OTHER INFORMATION		17
SIGNATURES		18

### WATERSIDE CAPITAL CORPORATION

#### Balance Sheets

June 30, 2000 and March 31, 2001

-----

	June 30, 2000 ----
<b>Assets:</b>	
Investments in portfolio companies, at fair value (note 3):	
Equity securities	\$ 23,237,050
Debt securities	8,877,766
Options and warrants	3,752,744
	-----
Total investments, cost of \$37,826,396 and \$42,037,060 at June 30, 2000 and March 31, 2001, respectively	35,867,560 -----
<b>Current assets:</b>	
Cash and cash equivalents	118,314
Dividends receivable	654,767
Interest receivable	222,517
Note receivable	237,550
Refundable income taxes	323,322
Prepaid expenses and other current assets	140,403
	-----
Total current assets	1,696,873
Property and equipment, net	167,919
Deferred income taxes, net of valuation allowance of \$1,689,000 at March 31, 2001	650,000
Deferred financing costs, net	716,391
	-----
Total assets	\$ 39,098,743 =====
<b>Liabilities and Stockholders' Equity:</b>	
<b>Current liabilities:</b>	
Lines of credit	\$ 2,200,000
Accounts payable	31,310
Accrued expenses	733,042
	-----

Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

Total current liabilities	2,964,352
Debentures payable (note 4)	19,300,000
Total liabilities	22,264,352
Stockholders' equity:	
Common stock, \$1 par value, 10,000,000 shares authorized, 1,581,430 issued and outstanding	1,581,430
Preferred stock, \$1 par value, 25,000 shares authorized, no shares issued and outstanding	-
Additional paid-in capital	14,618,719
Net unrealized depreciation on investments, net of income taxes	(1,216,357)
Undistributed accumulated earnings	1,850,599
Total stockholders' equity	16,834,391
Commitments and contingencies	
Total liabilities and stockholders' equity	\$ 39,098,743
Net asset value per common share	\$ 10.65

See accompanying notes to financial statements.

2

WATERSIDE CAPITAL CORPORATION

Unaudited Statements of Operations

Three months and nine months ended March 31, 2000 and 2001

	Three Months ended March 31,	
	2000	2001
Operating income:		
Dividends	\$ 676,760	\$ 736,
Interest on debt securities	313,819	301,
Interest on cash equivalents	1,608	1,
Fee and other income	222,649	110,
Total operating income	1,214,836	1,149,
Operating expenses:		
Salaries and benefits	262,971	243,
Legal and accounting	39,480	71,
Interest expense	340,334	497,
Other operating expenses	124,489	108,
Total operating expenses	767,274	920,

Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

Net operating income before income taxes	447,562	228,
Income tax benefit	(56,000)	(146,
Net operating income	503,562	374,
Realized gain on investments, net of income taxes of \$469,000 and \$40,000 for the three months ended March 31, 2000 and 2001, respectively, and \$1,075,000 and \$40,000 for the nine months ended March 31, 2000 and 2001, respectively	765,821	66,
Change in unrealized appreciation (depreciation) on investments, net of income tax expense (benefit) of \$(44,000) and \$106,000 for the three months ended March 31, 2000 and 2001, respectively, and \$432,000 and \$(168,000) for the nine months ended March 31, 2000 and 2001, respectively	(73,897)	(2,639,
Net increase (decrease) in stockholders' equity resulting from operations	\$1,195,486	\$ (2,199,
Net increase (decrease) in stockholders' equity resulting from operations per share - basic (note 5)	\$ 0.76	\$ (1
Net increase (decrease) in stockholders' equity resulting from operations per share - diluted (note 5)	\$ 0.75	\$ (1

See accompanying notes to financial statements.

3

WATERSIDE CAPITAL CORPORATION

Unaudited Statements of Changes in Stockholders' Equity

Nine months ended March 31, 2000 and 2001

	Common stock Shares	Amount	
	-----	-----	-----
Balance at June 30, 1999	1,491,937	\$ 1,491,937	\$
6% stock dividend	89,493	89,493	
Capitalization of undistributed accumulated earnings	-	-	
Repayment of stockholders' notes receivable	-	-	
Net operating income	-	-	
Net realized gain on investments, net of income taxes	-	-	
Increase in net unrealized appreciation on investments, net of income taxes	-	-	
Balance at March 31, 2000	1,581,430	\$ 1,581,430	\$

Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

	Undistributed accumulated earnings -----	Stockholders' notes receivable -----
Balance at June 30, 1999	\$ 966,003	\$ (1,455,000)
6% stock dividend	(738,508)	-
Capitalization of undistributed accumulated earnings	(1,200,000)	-
Repayment of stockholders' notes receivable	-	1,455,000
Net operating income	1,253,103	-
Net realized gain on investments, net of income taxes	1,751,974	-
Increase in net unrealized appreciation on investments, net of income taxes	-	-
	-----	-----
Balance at March 31, 2000	\$ 2,032,572	\$ -
	=====	=====

	Common stock Shares -----	Amount -----	
Balance at June 30, 2000	1,581,430	\$ 1,581,430	\$
Net operating income	-	-	
Net realized gain on investments, net of income taxes	-	-	
Increase in net unrealized depreciation on investments, net of income taxes	-	-	
	-----	-----	
Balance at March 31, 2001	1,581,430	\$ 1,581,430	\$
	=====	=====	

	Undistributed accumulated earnings -----	Stockholders' notes receivable -----
Balance at June 30, 2000	\$ 1,850,599	\$ -
Net operating income	1,030,727	-
Net realized gain on investments, net of income taxes	66,457	-
Increase in net unrealized depreciation on		

Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

investments, net of income taxes	-	-
	-----	-----
Balance at March 31, 2001	\$ 2,947,783	\$ -
	=====	=====

See accompanying notes to financial statements.

4

WATERSIDE CAPITAL CORPORATION

Unaudited Statements of Cash Flows

Nine months ended March 31, 2000 and 2001

	2000
	----
Cash flows from operating activities:	
Net increase (decrease) in stockholders' equity resulting from operations	\$ 3,708,
Adjustments to reconcile net increase (decrease) in stockholders' equity resulting from operations to net cash provided by operating activities:	
Change in unrealized appreciation/depreciation on investments	(1,135,
Realized gain on investments	(2,826,
Accretion of preferred stock and loan investments	(254,
Depreciation and amortization	51,
Deferred income tax expense (benefit)	466,
Loss on disposal of property and equipment	
Changes in assets and liabilities increasing (decreasing) cash flows from operating activities:	
Dividends receivable	(448,
Interest receivable	(14,
Refundable income taxes	43,
Prepaid expenses and other current assets	(54,
Other assets	
Accounts payable and accrued expenses	(112,
Deferred revenue	(110,
Income taxes payable	92,
	-----
Net cash provided by (used in) operating activities	(594,
	-----
Cash flows from investing activities:	
Investments in equity securities made	(8,618,
Investments in debt securities made	(4,764,
Principal collected on debt securities	1,190,
Proceeds from repayment of stockholders' notes receivable	1,455,
Proceeds from sales of investments	3,615,
Acquisition of property and equipment	(13,
Proceeds from sale of property and equipment	2,
	-----
Net cash used in investing activities	(7,132,

Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

Cash flows from financing activities:	
Proceeds from (payments on) lines of credit	353,
Proceeds from debentures payable	7,000,
Payments in lieu of fractional shares associated with stock dividend	(
Payment of deferred financing costs	(175,
	-----
Net cash provided by financing activities	7,177,
	-----
Net increase (decrease) in cash and cash equivalents	(549,
Cash and cash equivalents, beginning of period	1,269,
	-----
Cash and cash equivalents, end of period	\$ 719,
	=====
Supplemental disclosure of cash flow information:	
Cash paid during the period for interest	\$ 907,
	=====
Cash paid during the period for income taxes	\$ 720,
	=====

See accompanying notes to financial statements.

5

WATERSIDE CAPITAL CORPORATION

Notes to Financial Statements

June 30, 2000 and March 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, 2000, as filed with the Securities and Exchange Commission.

(2) Description of Business

The Company was incorporated in the Commonwealth of Virginia on July 13,

## Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

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.

6

## WATERSIDE CAPITAL CORPORATION

### Notes to Financial Statements

-----  
Discounts can range from 0% to 40% for investment size and market liquidity concerns. Actual liquidity discounts in the portfolio at March 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 \$35,867,560 and \$35,191,250 at June 30, 2000 and March 31, 2001 (91.7% and 90.2% 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.

### (4) Debentures Payable

During the third quarter of fiscal 2001, the Company has drawn an additional \$3,000,000 against the total available SBA debentures of \$10,000,000. The debentures bear interest at an interim rate of 6.602% and mature on September 1, 2011. The interest rate will be fixed in September 2001.

7



Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

WATERSIDE CAPITAL CORPORATION

Notes to Financial Statements

(5) Net Increase (Decrease) in Stockholders' Equity Resulting from Operations per Share

The following table sets forth the calculation of basic and diluted net increase (decrease) in stockholders' equity resulting from operations per share for the three months and nine months ended March 31, 2000 and 2001:

	Three months ended March 31,		Nine months ended March 31,	
	2000	2001	2000	2001
Basic net increase (decrease) in stockholders' equity resulting from operations per share:				
Net increase (decrease) in stockholders' equity resulting from operations	\$1,195,486	(2,199,089)	3,708,831	(3,621,789)
Weighted average number of common shares outstanding	1,581,430	1,581,430	1,581,430	1,581,430
Basic net increase (decrease) in stockholders' equity resulting from operations per share	\$ 0.76	(1.39)	2.35	(2.29)
Diluted net increase (decrease) in stockholders' equity resulting from operations per share:				
Net increase (decrease) in stockholders' equity resulting from operations	\$1,195,486	(2,199,089)	3,708,831	(3,621,789)
Weighted average number of common shares outstanding	1,581,430	1,581,430	1,581,430	1,581,430
Dilutive effect of stock options (as determined using the treasury stock method)	2,236	-	5,676	-
Adjusted weighted average number of common shares outstanding	1,583,666	1,581,430	1,587,106	1,581,430
Diluted net increase (decrease) in stockholders' equity resulting from operations per share	\$ 0.75	(1.39)	2.34	(2.29)

Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

8

WATERSIDE CAPITAL CORPORATION

Schedule of Portfolio Investments

June 30, 2000 and March 31, 2001

-----  
 The Company's investment portfolio at June 30, 2000 consisted of the following:

Equity Securities:	Number of shares
-----	
Publicly Traded Companies:	
Avery Communications, Inc. Common Stock	245,000
Netplex Group, Inc. Common Stock (a)	66,400
Netplex Group, Inc. Preferred Stock	1,500,000
Electronic Business Systems, Inc. (formerly Triangle Imaging Group, Inc.) Convertible Preferred Stock (b) (c)	700
Electronic Business Systems, Inc. (formerly Triangle Imaging Group, Inc.) Common Stock (b) (c)	500,000
Electronic Business Systems, Inc. (formerly Triangle Imaging Group, Inc.) Common Stock (b) (c)	1,423,821
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	2,000
JMS Worldwide, Inc. Preferred Stock	1,500
EPM Development Systems Corp. Preferred Stock	1,500
Fire King International Preferred Stock	2,000
SECC (formerly MilleCom, Inc.) Common Stock	840,000
Eton Court Asset Management, Ltd. Preferred Stock	1,000
Fairfax Publishing Co., Inc. Preferred Stock	1,100
DigitalSquare.com 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	1,500
Jubilee Tech International, Inc. Convertible Preferred Stock	2,200,000
VentureCom, Inc. Preferred Stock	278,164
Total equity securities	

Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

Debt Securities: -----	Maturity -----	C ---
Avery Communications, Inc. Convertible Note	12/10/02	\$
Extraction Technologies of VA, LLC	7/22/03	
Extraction Technologies of VA, LLC	8/31/04	
Extraction Technologies of VA, LLC	11/2/04	
Extraction Technologies of VA, LLC	2/7/05	
Extraction Technologies of VA, LLC	2/25/05	
Extraction Technologies of VA, LLC	3/14/05	
JMS Worldwide, Inc.	7/31/03	
Diversified Telecom, Inc.	Demand	
Diversified Telecom, Inc.	5/19/02	
SECC (formerly MilleCom, Inc.)	3/31/04	
SECC (formerly MilleCom, Inc.)	5/11/04	
ISR Solutions, Inc.	6/30/04	
Fire King International	Demand	
TABET Manufacturing Co., Inc.	12/31/04	
National Assisted Living, LP	12/31/04	
Electronic Business Systems, Inc. (formerly Triangle Imaging Group, Inc.) (b)	1/31/05	
New Dominion Pictures LLC	4/30/06	
Total debt securities		

9

WATERSIDE CAPITAL CORPORATION

Schedule of Portfolio Investments

June 30, 2000 and March 31, 2001 (Unaudited)

-----

Stock Options and Warrants: -----	Number of shares -----	Percentage ownership -----	Cost or contributed value -----
Publicly Traded Companies:			
Avery Communications, Inc.	161,000	0.00	\$ -
Netplex Group, Inc. (a)	300,000	2.10	900,000
Electronic Business Systems, Inc. (formerly Triangle Imaging Group, Inc.) (a) (b)	56,000	0.39	-
Private Companies:			
Real Time Data Management Services, Inc.	125	29.41	115,000
Delta Education Systems, Inc.	639	39.00	48,200

Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

Diversified Telecom, Inc.	8,998	15.00	-
Crispies, Inc.	524	6.37	2,800
Triangle Biomedical Sciences	50,743	11.70	127,449
Extraction Technologies of VA, LLC	-	39.00	337,567
JMS Worldwide, Inc.	199	5.00	-
EPM Development Systems Corp.	87	8.00	11,600
Fire King International	4	4.00	-
SECC (formerly MilleCom, Inc.)	150,000	3.15	-
Eton Court Asset Management, Ltd.	14,943	13.00	34,700
Fairfax Publishing Co., Inc.	526	16.50	73,600
ISR Solutions, Inc.	550,973	7.20	12,936
DigitalSquare.com	81,074	5.70	-
Answernet, Inc.	69,837	17.64	268,615
TABET Manufacturing Co., Inc.	500,000	20.00	175,400
National Assisted Living, LP	-	15.00	667,000
Capital Markets Group, Inc.	2,294,118	15.00	-
Jubilee Tech International, Inc.	400,000	1.60	240,000
Signius Investment Corporation	12	11.67	332,595
VentureCom, Inc.	38,943	0.37	-
New Dominion Pictures LLC	-	9.00	464,650
			-----
Total options and warrants			3,812,112
			-----
Total investments			\$37,826,396
			=====

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

Equity Securities:	Number of shares	Co cont v
-----	-----	-----
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	1,
Netplex Group, Inc. Common Stock	66,400	
Netplex Group, Inc. Preferred Stock	1,500,000	1,
Electronic Business Systems, Inc. (formerly Triangle Imaging Group, Inc.) Convertible Preferred Stock (b) (c)	700	2,
Electronic Business Systems, Inc. (formerly Triangle Imaging Group, Inc.) Common Stock (b) (c)	500,000	
Electronic Business Systems, Inc. (formerly Triangle Imaging Group, Inc.) Common Stock (b) (c)	1,423,821	
Primal Solutions, Inc. Common Stock	715,167	

## Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

WATERSIDE CAPITAL CORPORATION

Schedule of Portfolio Investments

June 30, 2000 and March 31, 2001 (Unaudited)

-----

	Number of shares -----
<b>Private Companies:</b>	
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	2,100
JMS Worldwide, Inc. Preferred Stock	1,500
EPM Development Systems Corp. Preferred Stock	1,500
Fire King International Preferred Stock	2,000
SECC (formerly MilleCom, Inc.) Common Stock	840,000
Eton Court Asset Management, Ltd. Preferred Stock	1,000
Fairfax Publishing Co., Inc. Preferred Stock	1,100
DigitalSquare.com 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	1,500
Jubilee Tech International, Inc. Convertible Preferred Stock	2,200,000
VentureCom, Inc. Preferred Stock	278,164
Phoenix Fabrications, Inc. Preferred Stock	400
AmeriComm Direct Marketing LLC Preferred Stock	27,696
Total equity securities	

<b>Debt Securities:</b>	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.	Demand
Diversified Telecom, Inc.	5/19/02

Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

ISR Solutions, Inc.	6/30/04
Fire King International	Demand
TABET Manufacturing Co., Inc.	12/31/04
National Assisted Living, LP	12/31/04
New Dominion Pictures LLC	4/30/06
Mayfair Enterprises, Inc.	7/18/05
DigitalSquare.com	9/15/05

Phoenix Fabrications, Inc.	9/8/05
Kotarides Baking Co. of VA	6/5/01
AmeriComm Direct Marketing LLC	12/29/05
Triangle Biomedical Sciences	12/8/01

Total debt securities

11

WATERSIDE CAPITAL CORPORATION

Schedule of Portfolio Investments

June 30, 2000 and March 31, 2001

Stock Options and Warrants:	Number of shares	Percentage ownership	Cost or contributed value	Fai
-----	-----	-----	-----	
Publicly Traded Companies:				
Netplex Group, Inc. (a)	300,000	2.10	\$ 900,000	\$
Electronic Business Systems, Inc. (formerly Triangle Imaging Group, Inc.) (a) (b)	98,000	0.63	-	
Private Companies:				
Real Time Data Management Services, Inc.	125	29.41	115,000	
Delta Education Systems, Inc.	639	39.00	48,200	
Diversified Telecom, Inc.	8,998	15.00	-	
Crispies, Inc.	524	6.37	2,800	
Triangle Biomedical Sciences	632,916	12.20	171,967	
Extraction Technologies of VA, LLC (d)	-	39.00	337,567	
JMS Worldwide, Inc.	199	5.00	-	
EPM Development Systems Corp.	87	8.00	11,600	
Fire King International	4	4.00	-	
SECC (formerly MilleCom, Inc.)	150,000	3.15	-	
Eton Court Asset Management, Ltd.	14,943	13.00	34,700	
Fairfax Publishing Co., Inc.	1,026	20.30	123,238	
ISR Solutions, Inc.	588,334	5.90	12,936	
DigitalSquare.com	150,000	-	75,000	
Answernet, Inc.	69,837	16.50	268,615	
TABET Manufacturing Co., Inc.	487,500	19.50	175,400	
National Assisted Living, LP	-	15.00	667,000	
Capital Markets Group, Inc.	2,294,118	15.00	-	
Jubilee Tech International, Inc.	400,000	1.60	240,000	

**Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q**

Signius Investment Corporation	12	11.67	332,595
VentureCom, Inc.	38,943	0.37	-
New Dominion Pictures LLC	-	9.00	464,650
Mayfair Enterprises, Inc.	-	15.00	214,400
Phoenix Fabrications, Inc.	-	25.00	297,000
Kotarides Baking Co. of VA	-	13.75	185,625
			-----
Total options and warrants			4,678,293
			-----
Total investments			\$ 42,037,060
			=====

- (a) Rule 144A restricted securities.
- (b) This entity, which is considered an affiliate of the Company, 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.

12

ITEM 2

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

o 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.

o Results of Operations

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

## Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

For the three months ended March 31, 2001, total operating income was \$1,149,000 compared to \$1,215,000 reported during the same period of 2000. The decrease in operating income is due to a reduction in fee income due to the origination of fewer investments during the quarter. The March 31, 2001 quarterly operating income consisted of dividends of \$737,000, interest on debt securities of \$301,000, fee income of \$110,000 and interest on cash equivalents of \$1,000.

Total operating expenses for the three months ended March 31, 2001, were \$921,000, consisting of interest expense of \$497,000, salaries and benefits of \$244,000, legal and accounting expense of \$71,000, and other operating expenses of \$109,000. These expenses compared to the \$767,000 for the three months ended March 31, 2000, consisting of interest expense of \$340,000, salaries and benefits of \$263,000, legal and accounting expenses of \$39,000, and other operating expenses of \$125,000. The significant increase in interest expense for the quarter ended March 31, 2001, compared to the quarter ended March 31, 2000 is due to the increased borrowings made to fund the Company's investment portfolio. Net operating income of \$374,000 for the three months ended March 31, 2001, compared to the \$504,000 reported for the three months ended March 31, 2000.

The realized gain on investments of \$766,000 for the three months ended March 31, 2000, was due to an after tax gain on the Company's holdings in the publicly traded investment The Netplex Group. The increase in unrealized depreciation on investments net of taxes of \$2,640,000 for the

13

three months ended March 31, 2001 is primarily due to an additional write down of a portfolio company (Extraction Technologies of Virginia) that filed for bankruptcy protection under Chapter 11 of the U. S. Bankruptcy Code in order to restructure contractual and debt obligations. The remainder of the increase in unrealized depreciation for the three months ended March 31, 2001 is attributable to the write down of \$1.5 million related to Capital Markets Group, Inc. due to its deteriorating financial condition.

The net increase (decrease) in stockholders' equity resulting from operations was a decrease of \$2,199,000 or \$1.39 per share for the quarter ended March 31, 2001, compared to an increase of \$1,195,000 or \$0.75 per share on a fully diluted basis, for the comparable period ended March 31, 2000.

### Comparison of Nine Months Ended March 31, 2001 and March 31, 2000

For the nine months ended March 31, 2001, total operating income was \$3,181,000 compared to \$3,035,000 reported during the same period of 2000. The increase in operating income is due to the increase in interest and dividend income as a result of the growth in the Company's investment portfolio as compared to 2000, partially offset by the reduction in fee income due to the origination of fewer investments during the most recent nine-month period. The March 31, 2001 year-to-date operating income consisted of dividends of \$2,097,000, interest on debt securities of \$760,000, fee income of \$315,000, and interest on cash equivalents of \$9,000.

Total operating expenses for the nine months ended March 31, 2001 were \$2,615,000, consisting of interest expense of \$1,455,000, salaries and benefits of \$699,000, legal and accounting expense of \$165,000, and other



## Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

operating expenses of \$296,000. These expenses compared to the \$1,967,000 for the nine months ended March 31, 2000, consisting of interest expense of \$834,000, salaries and benefits of \$692,000, legal and accounting expenses of \$113,000, and other operating expenses of \$328,000. The significant increase in interest expense for the nine months ended March 31, 2001, compared to the nine months ended March 31, 2000 is due to the increased borrowings made to fund the growth in the company's investment portfolio. For the nine months ended March 31, 2001, net operating income was \$1,031,000 or \$0.65 per share compared to the \$1,253,000 or \$0.79 per share reported for the same nine-month period of the previous fiscal year.

During the nine months ended March 31, 2000, Waterside realized an aftertax gain of \$1.8 million on its holdings in The Netplex Group. In addition, Waterside had an increase in after tax unrealized gains on investments of \$0.7 million, primarily due to increases in the fair values of its publicly traded investments. Net of taxes, total realized and unrealized gains on investments added \$2.5 million to total income during the nine months ended March 31, 2000.

During the nine months ended March 31, 2001, Waterside recorded an aftertax unrealized depreciation in the fair value of its investments of \$4.7 million, primarily due to the deteriorating financial condition of three portfolio companies, two of which filed for bankruptcy protection under Chapter 11 of the US Bankruptcy Code. The write downs for the companies in bankruptcy were \$1.3 million for Electronic Business Systems, Inc., and \$2.0 million for Extraction Technologies of Virginia, LLC, with an additional write down of \$1.5 million for Capital Markets Group, Inc. In addition, during the nine months ended March 31, 2001, the Company recorded a valuation allowance of \$1,689,000 on its deferred tax assets due to greater uncertainty as to the realization of these tax benefits.

Stockholders' equity resulting from operations decreased \$3,622,000 or \$2.29 per share for the March 31, 2001 nine-month period, compared to an increase of \$3,709,000 or \$2.34 per share on a fully diluted basis, for the comparable period ended March 31, 2000.

14

### o Financial Condition, Liquidity And Capital Resources

At March 31, 2001 the Company's Investment portfolio totaled \$35.2 million compared with the \$35.9 million reported at June 30, 2000. For the nine months ended March 31, 2001 the Company funded \$5.8 million in investments compared to the \$13.4 million funded during the comparable nine months of 2000. To fund these new investments, the company borrowed \$6.1 million from the SBA during the nine months ended March 31, 2001.

Net asset value per common share decreased to \$8.35 per share at March 31, 2001, from \$10.65 per share at June 30, 2000. This reduction in net asset value is a result of the investment write downs previously discussed.

During the nine months ended March 31, 2001, net cash provided by operating activities was \$161,000 as compared to the \$595,000 used during the nine months ended March 31, 2000. Refunded income taxes of \$323,000 contributed significantly to the cash provided during the nine months ended March 31, 2001. The Company used \$3.7 million in investing activities during the nine months ended March 31, 2001 as compared to the \$7.1 million used in investing activities for the nine months ended March

## Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

31, 2000, primarily due to the reduction in investment origination as described above, partially offset by proceeds from sale of investments and repayment of loans. Cash flows provided by financing activities for the nine months ended March 31, 2001 were \$3.7 million compared to the \$7.2 million provided during the nine months ended March 31, 2000. The increases relate to net borrowings in 2000 as compared to 2001 to finance investment origination.

### o Quantitative and Qualitative Disclosure About Market Risk

The Company's business activities contain elements of 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. 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 equity interests 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 four of the Company's thirty investments are in thinly traded, small public companies, whose stock prices have been volatile. The other twenty-six 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 subject to the estimate of 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 equity securities of \$35.2 million at March 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 significantly.

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 affected net increase in stockholders' equity resulting from operations significantly over a three month horizon. Although management believes that this measure is

## Edgar Filing: WATERSIDE CAPITAL CORP - Form 10-Q

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 net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

### o 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 Commission, news releases and investor presentations, are forward-looking statements about business objectives and strategies, market potential, 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. 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.