WATERSIDE CAPITAL CORP
Form N-5
December 13, 2005
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As filed with the Securities and Exchange Commission on December 13, 2005

Registration No. 333-______

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form N-5

REGISTRATION STATEMENT OF SMALL BUSINESS INVESTMENT COMPANY

UNDER

THE SECURITIES ACT OF 1933 AND THE INVESTMENT COMPANY ACT OF 1940

WATERSIDE CAPITAL CORPORATION

(Exact name of registrant as specified in its charter)

Waterside Capital Corporation
500 East Main Street, Suite 800
Norfolk, Virginia 23510
(757) 626-1111
(Address of principal executive offices)

J. Alan Lindauer
President and Chief Executive Officer
Waterside Capital Corporation
500 East Main Street, Suite 800
Norfolk, Virginia 23510
(757) 626-1111
(Name and address of agent for service)

With a copy to:

Bradley A. Haneberg, Esq.

Kaufman & Canoles, P.C.

Three James Center

1051 East Cary Street, 12th Floor

Richmond, Virginia 23219

Approximate date of commencement of proposed sale of the securities to the public: As soon as practicable after the Effective Date of this Registration Statement.

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of securities to be registered	Amount being registered (2)	Proposed maximum offering price per share (3)	Proposed maximum aggregate offering price (3)	Amount of registration fee (4)
Rights to purchase common stock (1)	1,456,675			
Common stock	1,456,675	$3.85	$5,608,199	$601

(1) Evidencing the rights to subscribe for shares of common stock of the Registrant being registered herewith. Pursuant to Rule 457(g) of the Securities Act of 1933, no separate registration fee is required for the rights because the rights are being registered in the same registration statement as the common stock of the Registrant underlying the rights.

(2) Represents one Subscription Right for each share of common stock of the Registrant outstanding as of the Record Date.

(3) Estimated solely for the purpose of calculating the registration fee. Based on the average high and low prices reported on the NASDAQ Capital Market on December 7, 2005 (i.e., a specified date within 5 business days prior to the date of filing of this registration statement).

(4) Calculated in accordance with Rule 457(c) of the Securities Act of 1933, as amended, based on the estimated maximum aggregate offering price of the common stock of the Registrant.

WE HEREBY AMEND THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL WE SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(a) OF THE SECURITIES ACT OF 1933, AS AMENDED, OR UNTIL THIS REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SECTION 8(a), MAY DETERMINE.

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WATERSIDE CAPITAL CORPORATION

CROSS REFERENCE SHEET

(Pursuant to Rule 481 showing the location in the Prospectus of the responses to the

Items of Parts I and II of Form N-5)

Item No. and Caption	Prospectus Caption
1. Organization and Business	Our Company General
2. Fundamental Policies of Registrant	See Part I
3. Policies with Respect to Security Investments	See Part I
4. Ownership of Voting and Convertible Securities of Other Issuers	Our Business Portfolio Companies
5. Special Tax Provisions Applicable to Registrant	Federal Income Tax Considerations
6. Pending Legal Proceedings	Our Business - Litigation
7. Summary of Earnings	Summary Financial Information
8. Persons in Control Relationships with Registrant	Principal Shareholders
9. Persons Owning Equity Securities of Registrant	Principal Shareholders
10. Number of Holders of Equity Securities of Registrant	Description of Capital Stock Common Stock
11. Directors and Executive Officers	Management Directors and Executive Officers
12. Members of Advisory Board of Registrant	Not Applicable
13. Remuneration of Directors, Officers and Members of Advisory Board	Compensation
14. Indemnification of Officers and Directors	Indemnification
15. Custodians of Portfolio Securities	Custodian
16. Investment advisers	Not Applicable
17. Business and Other Connections of Investment Advisers and Their Managements	Not Applicable
18. Interest of Affiliated Persons in Certain Transactions	Related Party Transactions
19. Capital Stock	Description of Capital Stock Common Stock and Description of Capital Stock Preferred Stock
20. Long-Term Debt	Description of Capital Stock Long Term Debt
21. Other Securities	Not Applicable
22. Financial Statements	See response to Item 28
23. Distribution Spread	Not Applicable
24. Plan of Distribution	Common Stock Rights Offering Distribution Agreements
25. Use of Proceeds to Registrant	Use of Proceeds
26. Sales Otherwise Than for Cash	Not Applicable
27. Information Required by Items of Part I	See above
28. Financial Statements Required by Item 22 of Part I	Financial Statements

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PART I

INFORMATION REQUIRED IN REGISTRATION STATEMENT

UNDER THE INVESTMENT COMPANY ACT OF 1940

(For Part I Items contained in the

Prospectus, see Cross Reference Sheet)

ITEM 2. FUNDAMENTAL POLICIES OF REGISTRANT.

Our policies relating to the activities described below are matters of fundamental policy in accordance with Sections 8(b) and 13(a) of the Investment Act Company Act of 1940, as amended (the Investment Act). We may not change these policies without the approval of the lesser of (i) shareholders collectively holding at least 67% of our voting securities present or represented at a shareholders meeting at which the holders of more than 50% of such shares are present or represented or (ii) shareholders collectively holding more than 50% of our outstanding voting securities. Undefined capitalized terms have the meanings ascribed in the attached Prospectus.

(a) We are permitted to issue the maximum amount of SBA borrowed funds (SBA Debentures) permitted by the Small Business Investment Act of 1958, as amended (the SBA Act) and SBA regulations. As of December 13, 2005, we have issued $21,400,000 of SBA Debentures and anticipate issuing more in the foreseeable future.

(b) We are permitted to borrow money only for the purpose of investments in, and making loans to, small business concerns. We are permitted, however, to finance the acquisition of capital assets used in our ordinary business operations.

(c) We are not permitted to engage in the business of underwriting the securities of other issuers. We anticipate that all or substantially all of our investments in small business concerns will be in securities that may not be sold to the public without registration under the Securities Act of 1933, as amended. With the exception of a single investment, all of our current equity investments in small business concerns are so restricted.

(d) We are prohibited from concentrating more than 30% of the value of our assets, determined at the time an investment is made, exclusive of U.S. government securities, in securities issued by companies primarily engaged in the same industry.

(e) We are prohibited from engaging in the business of purchasing or selling real estate. We may bring mortgage foreclosure actions and take title to and possession of property with respect to which we are the mortgagee in accordance with applicable mortgage foreclosure laws. Additionally, we may purchase office facilities, although, at present we lease our office facilities.

(f) We are not permitted to engage in the purchase or sale of commodities or commodity contracts.

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(g) We are permitted to make loans to small business concerns to the extent allowed by the SBA Act and SBA regulations.

ITEM 3. POLICIES WITH RESPECT TO SECURITY INVESTMENTS.

Our policies with respect to the following matters are not fundamental policies and may be changed, subject to the SBA Act and SBA regulations, by the Executive Committee of our Board of Directors without shareholder approval.

(a) We may make investments in equity and debt securities of small business concerns as approved by our Executive Committee. We do not have a strict policy regarding the percentage of our assets that may be invested in any specific type of security.

(b) We follow SBA regulations prohibiting an investment in any single small business concern and its affiliates exceeding 20% of our Regulatory Capital (defined as Private Capital less certain non-cash assets).

(c) As permitted by SBA regulations, we may purchase (i) up to 49% of the voting securities of a small business concern if the small business concern has fewer than 50 shareholders or (ii) up to 19% (and in certain situations up to 25%) of the voting securities of a small business concern if the small business concern has 50 or more shareholders.

(d) Except where necessary to protect an investment, we do not invest in companies for the purpose of exercising control of management and do not intend to do so in the future. SBA regulations prohibit small business investment companies from controlling a small business concern except where necessary to protect an investment.

(e) We do not invest in securities of other investment companies and do not intend to do so in the future.

(f) We intend to hold our portfolio debt securities for a minimum of five years as required by SBA regulations or until maturity. We anticipate retaining our equity investments from five to seven years.

(g) We have adopted a code of ethics under Rule 17j-1 of the Investment Company Act. This code permits our personnel subject to the code to invest in securities, including securities that are held by Waterside or securities that may be purchased or held by our company. Nonetheless, our code of ethics places significant restrictions upon these investments to avoid conflicts of interest and to ensure that our shareholders interests are paramount. A copy of our code of ethics can be reviewed and copied at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information relating to the operation of the SEC s Public Reference Room may be obtained by calling the SEC at (202) 942-8090. The code is also available on the SEC s website at www.sec.gov, and copies of the code may be obtained, upon the payment of a duplication fee, by electronic request at the following email address: publicinfo@sec.gov or by writing to the SEC s Public Reference Section at 100 F Street, N.E., Washington, D.C. 20549.

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THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. WE MAY NOT ISSUE THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL OR ISSUE THESE SECURITIES AND IS NOT SOLICITING AN OFFER TO PURCHASE OR ACCEPT THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

PRELIMINARY PROSPECTUS **SUBJECT TO COMPLETION** **December 13, 2005**

1,456,675 Shares

Issuable Upon Exercise of Rights to Purchase Common Stock

WATERSIDE CAPITAL CORPORATION

Each of our shareholders as of [___, 2005] (the Record Date) shall receive, at no cost, one non-transferable right (each whole right, a Subscription Right) to purchase one share of our common stock, $1.00 par value per share, for each share of our common stock such shareholder owns as of the Record Date (the Primary Right). We intend to offer shares of common stock to our shareholders for a price equal to the average closing price of our common stock over the twenty consecutive trading days ending on the Expiration Date. The offer to purchase common stock will expire at 5:00 p.m., Eastern time, on [________], 2005, unless we decide to extend it to some later date (the Expiration Date).

If you elect to purchase the maximum amount of our common stock that you are entitled to pursuant to your Primary Right, you will also be entitled to subscribe, subject to allotment, to purchase additional shares of our common stock, if any, that are not purchased by our other shareholders pursuant to their Primary Right as of the Expiration Date (the Over-Subscription Privilege). If you do not fully subscribe for your Primary Right, your ownership may be diluted. See Risk Factors Risks Related to this Offering If you do not fully exercise your Primary Right, you will experience dilution. As used herein, we collectively refer to the terms Subscription Right and Over-Subscription Privilege as the Rights.

The Rights are non-transferable; however, the common stock issuable upon the exercise of the Rights will be listed for trading on the NASDAQ Capital Market. Our common stock is currently traded on the NASDAQ Capital Market under the symbol WSCC.

Please read this prospectus carefully before investing and keep it for future reference. It contains important information that a prospective investor ought to know before investing in our business. All questions and inquiries relating to the Rights should be directed to us at Waterside Capital Corporation, 500 East Main Street, Suite 800, Norfolk, Virginia 23150, Attention: Gerald T. McDonald, Secretary, telephone: (757) 626-1111. We have filed additional information about our business with the Securities and Exchange Commission (www.sec.gov). Copies of our filings may be obtained upon request by writing to us.

An investment in the Fund involves risks. See Risk Factors beginning on page 8.

These securities have not been approved or disapproved by the Securities and Exchange Commission or any state securities commission nor has the Securities and Exchange Commission or any state securities commission passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

	Estimated Subscription Price	Estimated Sales Load	Proceeds to the Company (1)
Per Share	**$ 4.00**		**$ 4.00**
Total (2)	**$ 5,826,700**		**$ 5,826,700**

(1) Before deduction of offering expenses we will incur, which are estimated to be $125,000.

(2) Assumes that all Subscription Rights are exercised.

The date of this prospectus is __________________, 2005

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PROSPECTUS SUMMARY

This summary highlights some of the information in this Prospectus. It may not contain all of the information that you may want to consider. You should read carefully the more detailed information set forth under Risk Factors and the other information included in this Prospectus. The terms we, us, the Company and our refer to Waterside Capital Corporation.

The Company

We began business operations in July 1996 after receiving a Small Business Administration (SBA) license and closing our initial private placement of common stock. We made our first portfolio investment in October 1996 and, as of December 13, 2005, have approximately $34.7 million in investments at fair value in 21 portfolio companies.

We are a non-diversified, closed-end investment company licensed by the SBA as a small business investment company (an SBIC) under the Small Business Investment Act of 1958, as amended (the SBA Act). We invest in equity and debt securities of small businesses to finance their growth, expansion and modernization. Our equity investments have generally been in the form of preferred stock bearing current-pay dividends. The weighted average dividend on our preferred stock investments is currently 11.95%. The weighted average annual interest rates on our loans is currently 12.39%. To date, we have made most of our investments in preferred stock because, as an SBIC, our dividend income is non-taxable. Our equity and debt financings are generally coupled with warrants to acquire common stock representing a minority interest in our portfolio companies. We seek to achieve current income from origination fees, preferred stock dividends and interest on loans, as well as long-term growth in the value of our net assets through the appreciation of our common stock positions in portfolio companies.

Rights Offering of Preference Common Stock

Each of our shareholders as of the Record Date shall receive, at no cost, one right (each, a Subscription Right) to purchase one share of common stock for each share of our common stock such shareholder owns as of the Record Date (the Primary Right). We intend to offer shares of common stock to these shareholders for a price (the Subscription Price) equal to the average closing price of our common stock over the twenty consecutive trading days ending on the Expiration Date. The offer to purchase common stock will expire at 5:00 p.m., New York City time, on [__________], 2005, unless we decide to extend it to some later date (the Expiration Date).

If you elect to purchase the maximum amount of our common stock that you are entitled to purchase pursuant to your Primary Right, you will also be entitled to subscribe, subject to allotment, to purchase additional shares of our common stock, if any, that are not purchased by our other shareholders pursuant to their Primary Right as of the Expiration Date (the Over-Subscription Privilege). See Common Stock Rights Offering Over-Subscription Privilege. If you do not fully subscribe for your Primary Right, your ownership is likely to be diluted. See Risk Factors Risks Related to this Offering If you do not fully exercise your Primary Right, you will experience dilution. The Subscription Rights and the Over-Subscription Privilege shall be collectively referred to below as the Rights.

How to Subscribe

Deliver a completed Common Stock Purchase Form (enclosed) and payment to our offices at the address below so that it is received by the Expiration Date (we recommend using an insured courier); or

If you hold shares of our common stock through a broker, dealer, trustee or other nominee, then that nominee is called the record holder of your shares. We will ask your record holder to notify you of this offering. If you wish to elect to purchase the common stock, you will need to have the record holder act for you. To indicate your decision about your rights, you should complete and return to the record holder, with the proper payment, a Beneficial Owner Election Form. You should receive this form from the record holder with the other offering materials.

Important Dates to Remember

Record Date	________________, 2005
Subscription Period	________________, 2005 (unless we extend the offer)
Expiration Date / Deadline to Purchase	________________, 2005 (unless we extend the offer)

The Offering

Common stock to be issued by us	1,456,675
Purpose of the Offering / Use of Proceeds	We expect to use the net proceeds of this offering to make additional equity and/or debt investments in new investment portfolio companies.
Subscription Rights	Each of our shareholders as of the Record Date shall receive, at no cost, one Subscription Right to purchase one share of our common stock for each share of our common stock such shareholder owns as of the Record Date (the Primary Right). We intend to offer shares of our common stock to these shareholders for a price (the Subscription Price) equal to the average closing price of our common stock over the twenty consecutive trading days ending on the Expiration Date.

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Over-Subscription Privilege	If you elect to purchase the maximum amount of our common stock that you are entitled to purchase pursuant to your Primary Right, you will also be entitled to subscribe, subject to allotment, to purchase additional shares of our common stock, if any, that are not purchased by our other shareholders pursuant to their Primary Right as of the Expiration Date (the Over-Subscription Privilege). See Common Stock Rights Offering Over-Subscription Privilege. If you do not fully subscribe for your Primary Right, your ownership is likely to be diluted. See Risk Factors Risks Related to this Offering If you do not fully exercise your Primary Right, you will experience dilution.
Expiration Date	5:00 p.m., Eastern Time, on _____________, unless we decide to extend it to some later date.
Risk Factors	See Risk Factors beginning on page 8 and the other information included in this prospectus for a discussion of risks that you should carefully consider about us and this offering.
Non-Transferability of the Rights	Your Rights are non-transferable. If you do not exercise them, you give up any right to the underlying shares of our common stock.
Termination of the Offering	Our Board of Directors may decide to terminate this offering at any time, on or before the Expiration Date. If we terminate the offering, our only obligation to you will be to return any payment, without interest.
Distribution Agreements	We do not intend to engage a dealer manager for the offer. Our officers and directors may solicit the exercise of Rights by our shareholders. The offer is not contingent upon any number of Rights being exercised. We will pay all expenses incurred in connection with the offer.

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Listing	Our common stock is currently listed on the NASDAQ Capital Market. We have applied to list the additional shares of common stock issued in connection with this offering.
Material United States Federal Income Tax Consequences	The receipt and election to purchase common stock are intended to be non-taxable events. If you sell the shares of common stock after purchasing them, you will recognize gain or loss. You should obtain specific tax advice from your personal tax advisor. See Federal Income Tax Considerations.
Available Information	We are subject to the reporting requirements of the Investment Company Act of 1940, as amended (the Investment Company Act) and are required to file reports, proxy statements and other information with the SEC. This information will be available at the SEC s public reference room at 100 F St. NE, Washington, D.C. 20549. You may call the SEC at 1-800-SEC-0330 for information on the operation of the public reference room. Our SEC filings are also available to the public on the SEC s Internet website at http://www.sec.gov.
Dilution	As a result of the terms of this offer, shareholders who do not fully exercise their Primary Rights will own, upon completion of this offer, a smaller proportional interest in us than they owned prior to the offer. In addition, because the Subscription Price may be less than net asset value per share, the offer may result in an immediate dilution of our net asset value per share. See Risk Factors Risks Related to this Offering If you do not fully exercise your Primary Right, you will experience dilution.

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SUMMARY FINANCIAL INFORMATION

	Year Ended June 30,					Three Months Ended September 30,	
	2001	2002	2003	2004	2005	2004	2005
Summary of Earnings Information:							
Operating Income:							
Dividends	$ 2,865,832	$ 2,007,981	$ 1,444,822	$ 1,059,292	$ 767,035	$ 40,187	$ 121,000
Interest on debt securities	1,008,202	1,220,768	1,353,940	1,412,148	1,470,747	519,076	356,008
Interest on notes receivable		12,723	36,596	166,052	311,244	75,713	78,319
Interest on cash equivalents	17,642	22,989	41,067	16,575	29,851	4,699	7,321
Fee and other income	354,827	462,522	316,321	357,120	123,054	10,116	8,877
Total operating income	4,246,503	3,726,983	3,192,746	3,011,187	2,701,931	649,791	571,525
Operating Expenses :							
Interest expense	1,913,544	2,019,865	2,025,651	1,896,734	1,806,302	469,137	427,700
Other	1,668,727	1,577,290	1,331,368	1,385,099	1,315,039	325,714	245,493
Total operating expenses	3,582,271	3,597,155	3,357,019	3,281,833	3,121,341	794,851	673,193
Recovery related to investee litigation, net			615,018				
Net operating income (loss) before income taxes	664,232	129,828	450,745	(270,646)	(419,410)	(145,060)	(101,668)
Income tax expense (benefit)	(675,000)						
Net operating income (loss)	1,339,232	129,828	450,745	(270,646)	(419,410)	(145,060)	(101,668)
Realized gain (loss) on investments, net of income taxes (1)	73,372	(3,213,047)	(6,896,966)	2,642,556	499,752	119,956	400,000
Change in unrealized appreciation (depreciation) on investments, net of income taxes (2)	(6,247,984)	(237,934)	10,585,917	(349,930)	1,400,795	9,127	(111,800)
Net increase (decrease) in stockholders equity resulting from operations	$ (4,835,380)	$ (3,321,153)	$ 4,139,696	$ 2,021,980	$ 1,481,137	$ (15,977)	$ 186,532
Net operating income (loss) per share - basic and diluted	$ 0.85	$ 0.08	$ 0.29	$ (0.18)	$ (0.29)	$ (0.10)	$ (0.07)
Net increase (decrease) in stockholders equity resulting from operations per share - basic and diluted	$ (3.06)	$ (2.11)	$ 2.66	$ 1.34	$ 1.02	$ (0.01)	$ 0.13
Weighted average number of shares outstanding	1,581,430	1,576,306	1,554,646	1,505,493	1,456,675	1,456,675	1,456,675

	At June 30,	At September 30,

	2001	2002	2003	2004	2005	2005
Balance Sheet Information:						
Loans and investments at fair value (3):						
Debt securities	$ 6,514,395	$ 8,463,170	$ 10,549,973	$ 12,766,273	$ 10,651,875	$ 10,005,938
Equity securities	23,146,571	15,304,120	12,547,868	9,858,319	10,140,938	10,442,138
Options and warrants	4,025,942	3,879,533	6,320,902	5,965,298	6,525,602	6,525,602
Assets acquired in liquidation of portfolio securities				250,000	2,597,054	3,092,420
Notes receivable		235,000	1,800,042	4,513,630	4,655,156	4,657,127
Total loans and Investments	33,686,908	27,881,823	31,218,785	33,353,520	34,570,625	34,723,225
Cash and cash equivalents	1,089,386	5,417,202	5,857,852	3,210,968	1,822,028	1,354,160
Total assets	38,378,758	35,081,369	38,881,380	38,499,312	37,854,684	37,581,939
Debentures payable	25,400,000	25,400,000	25,400,000	23,400,000	21,400,000	21,400,000
Total stockholders equity	11,999,011	8,605,658	12,719,754	14,300,283	15,781,420	15,967,952

(1) Amount presented net of income tax expense of $40,000 for 2001 and $0 for 2002, 2003, 2004, and 2005, and $0 for the three months ended September 30, 2004 and 2005.

(2) Amounts have been presented net of deferred income tax expense (benefit) of $191,000, $550,000, $0, $0 and $0 respectively, for the years ended June 30, 2001, 2002, 2003, 2004 and 2005, and $0 for the three months ended September 30, 2004 and 2005.

(3) The Company s loans and investments are presented at fair value, as determined by the Executive Committee of the Board of Directors, using the Mo del Valuation Policy as published by the Small Business Administration (SBA). The valuation policy includes estimates made by management in the absence of readily ascertainable market values. These estimated values may differ from those that would have been used had a ready market for the securities existed. See the Notes to the Company's Financial Statements included elsewhere herein. The cost of the loans and investments was $41,702,728, $35,349,098, $28,335,143, $30,819,808, and $30,636,118 at June 30, 2001, 2002, 2003, 2004 and 2005, respectively, and $30,900,518 at September 30, 2005.

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RISK FACTORS

Readers should consider carefully the specific factors set forth below as well as the other information included herein. All statements and information in this *prospectus*, other than statements of historical fact, are forward-looking statements based on a number of assumptions concerning future conditions that ultimately may prove to be inaccurate. These forward-looking statements may be identified by the use of words like believe, expect, intend, target and anticipate and concern, among other things, *our* ability to identify profitable investments in sm businesses, manage payment defaults, value its portfolio accurately and realize value from its investments in the securities of small businesses. Many phases of *our* operations are subject to influences outside our control. Any one or any combination of factors could have a material adverse effect on *our* business, financial condition and results of operations. These factors include competitive pressures, local, regional and national economic conditions, governmental regulation and policies and other conditions affecting capital markets. The following factors should be carefully considered, together with other information in this *prospectus.*

Risks Related to our Investments

Our investments are in highly speculative businesses. Our portfolio consists of equity and debt securities issued by small, privately owned businesses that, under SBA regulations, must have a tangible net worth of less than $18 million and average net income after federal income tax for the preceding two years of $6 million or less (computed without benefit of any carryover loss). Furthermore, 20% of our portfolio must consist of investments in smaller enterprises with a net worth of not more than $6 million and average net income after federal income tax for the preceding two years of $2 million or less (computed without benefit of any carryover loss). Our investments in these small businesses have primarily been in the form of preferred stock or subordinated debt, coupled with warrants to acquire shares of common stock. There is generally no publicly available information about such companies, so we must rely on the diligence of our employees and agents to obtain information in connection with our investment decisions. Typically, small businesses depend for their success on the management talents and efforts of one person or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse impact on our business, financial condition and results of operations. Moreover, small businesses frequently have smaller product lines and market shares than their competitors, may be more vulnerable to economic downturns and often need substantial additional capital to expand or compete. Such companies may also experience substantial variations in operating results. During fiscal 2005, we realized net profits of $500,000 on companies held in our portfolio. Investment in small businesses therefore involves a high degree of business and financial risk, can result in substantial losses and should be considered highly speculative.

Due to their speculative nature, our portfolio investments put our company at increased risk of payment defaults. Generally, we make current-pay, dividend-bearing preferred stock investments in, and nonamortizing, five-year term loans with fixed or variable rates of interest to, small businesses that have limited financial resources and are able to obtain only limited financing from traditional sources. Our loans may or may not be secured by the assets of the borrower. A portfolio company s ability to pay preferred stock dividends or to repay its loan may be adversely affected by numerous factors, including the failure to meet its business plan, the death, disability or resignation of senior management, a downturn in its industry or negative economic conditions. During fiscal 2005, two portfolio companies defaulted on quarterly dividend payments and one portfolio company defaulted on monthly interest payments. A deterioration in a portfolio company s financial condition and prospects usually will be accompanied by a deterioration in the value of its preferred stock or any collateral for a loan. As a holder of preferred stock, we are always subordinate to any indebtedness of the portfolio company and, when we are not the senior lender, any collateral for a loan will be subordinate to another lender s security interest.

Due to the nature of our investments, we must estimate the valuation of our portfolio investments. Typically, no public market exists for the equity or debt securities of small, privately owned companies. As a result, in the absence of readily ascertainable market values, the valuation of securities in our portfolio is made by the good faith determination of our Executive Committee in accordance with the SBA s model valuation policy, which we have adopted. The estimated values may differ significantly from the values that would have been established had a ready market for the securities existed, and the differences could be material. Unlike commercial lending institutions, we do not establish reserves for investment losses, but revalue our portfolio on a quarterly basis to reflect our estimate of the current fair value of the investment portfolio. There can be no assurance that this estimate is accurate and that we will not ultimately suffer losses on our investments. We currently hold an investment in one small publicly-held portfolio company whose stock price has been, and will likely continue to be, very volatile. This volatility will impact our overall valuation on a quarterly basis.

Due to the nature of our investments, we may not sell our investments easily. Most of our investments are, and will continue to be, securities acquired directly from small, privately owned companies. Our portfolio securities are, and will continue to be, subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of our portfolio securities may adversely affect our ability to dispose of such securities in a timely manner and at a fair price when necessary or advantageous.

Risks Related to our Company

We expect our operating results to fluctuate. We have experienced, and expect to continue experiencing variations in net operating income as a result of many factors. Accordingly, it is possible that our results of operations will be below the expectations of public market analysts and investors. In addition, we plan our operating expenditures based on operating income forecasts, and an operating income shortfall below our forecasts would likely adversely affect our business, financial condition and results of operations for the year.

Our common stock is thinly traded, and the price of our common stock will likely continue to fluctuate. Our common stock is listed on the NASDAQ Capital Market under the symbol WSCC. Continued inclusion requires that we maintain a minimum tangible net worth or net income standard and that our common stock satisfy minimum standards of public float, bid price and market makers. Our common stock has been, and is expected to continue to be thinly traded with a significant differential between the bid and ask price and a highly volatile trading price that will be subject to wide fluctuations in response to factors, many of which are beyond our control. These may include fluctuations in the operating results of our portfolio companies, sales of the common stock in the marketplace, shortfalls in our revenues, earnings or other operating results, general financial conditions and other factors. There can be no assurance that the market price of our common stock will not experience significant fluctuations that are material, adverse and unrelated to our performance. In addition, the stock market has from time to time experienced extreme price and volume fluctuations that often have been unrelated to the operating performance of particular companies. Changes in earnings estimates by analysts and economic and other external factors and period-to-period fluctuations in our financial results may have a significant impact on the market price of our common stock. Fluctuations or decreases in its trading price may adversely affect the liquidity of the trading market for our common stock.

Competition. A large number of institutions and individuals compete to make the types of investments we make. There can be no assurance that we will be able to identify and make investments that satisfy our investment objectives or that we will be able to invest fully our available capital. We compete with other SBICs, other non-bank financial companies and, to a limited extent, commercial banks and venture capital investors and venture capital investment firms. Most of our competitors have greater resources and significantly more operating history.

Our ability to operate profitably is dependent upon our access to SBA Leverage. An important aspect of our long term strategy in achieving investment returns is the use of SBA Debentures. Obtaining a license as an SBIC does not ensure that we will be able to obtain funds from the SBA (SBA Leverage) in the amounts required to optimize investment returns. The amount of available SBA Leverage is determined by annual Congressional appropriations. While our management believes that adequate SBA Leverage will be available, there can be no assurance that there will be sufficient SBA Leverage available to satisfy our demands or those of other SBICs. In addition, given our current capital structure, we will likely require the funds from this offering to obtain additional SBA Leverage. Absent additional capital, it is unlikely that we will be able to continue to grow the size of our portfolio through additional investments at the rate we have over prior fiscal years. We have currently issued $25,400,000 of SBA Debentures, of which $21,400,000 of SBA Debentures are currently outstanding. These issuances involve associated fixed costs. SBA Debentures require that interest be paid on a current basis, and the income from our investments may not be sufficient to make the required payments. Leverage increases the risk of loss because increased operating revenues are needed to make required payments of interest on loans. As such, losses on a small percentage of our investments and loans can result in a much larger percentage reduction in shareholders equity.

We are subject to regulation as an SBIC. As an SBIC, we are subject to a variety of regulations concerning, among other things, the size and nature of the companies in which we may invest and the structure of those investments. SBA regulations provide a variety of remedies if an SBIC fails to comply with these regulations. These remedies are graduated in severity depending on the severity of the SBIC s financial condition or misconduct. In certain circumstances, the SBA may prohibit an SBIC from making new investments or distributions to shareholders, require the removal of one or more officers or directors or obtain the appointment of a receiver for the SBIC. It is likely that new regulations governing SBICs will be adopted in the future and we cannot offer any assurance that any such new regulations will not have a material adverse effect on our business and results of operations. Although we are not aware of any pending legislation to eliminate the SBA or restrict or terminate the specific program of the SBA in which we participate, any significant restrictions on funds available to us from the SBA may adversely affect our plans for future operations and growth.

We do not expect to declare dividends upon our common stock. We have not declared or paid any cash dividends in the past and do not expect to pay cash dividends in the foreseeable future. We currently intend to retain our future earnings, if any, to finance the development and expansion of our business. Any future dividend policy will be determined by the Board of Directors in light of conditions then existing, including our earnings and our financial condition and requirements.

Provisions of our Articles of Incorporation may make it difficult for third parties to acquire our company. Our Articles of Incorporation authorize the Board of Directors to issue, without shareholder approval, 25,000 shares of preferred stock with voting, conversion and other rights and preferences that could materially and adversely affect the voting power or other rights of the holders of common stock. We presently have no plans or commitments to issue any shares of preferred stock. The issuance of preferred stock or of rights to purchase preferred stock, as well as certain provisions of our Articles of Incorporation and Virginia law, could delay, discourage, hinder or preclude an unsolicited acquisition of our company, make it less likely that shareholders receive a premium for their shares as a result of any such attempt and adversely affect the market price, and voting and other rights of the holders of common stock.

We will make investment decisions without shareholder knowledge or approval. We will make future unspecified investments in portfolio companies. As a result, the uncertainty and risk of an investment in our common stock is increased because investors will not be able to evaluate for themselves the economic merits of such future investments.

We may require additional financing in the future, and we cannot assure you that such financing will be available on terms that are acceptable to us. In order to make additional equity investments or extend credit, we may need to raise additional equity capital. Our ability to raise any additional required capital necessarily depends on the condition of the equity markets at the time we seek additional equity financing. We cannot assure you that we can, in the future, raise additional equity capital on acceptable terms.

We are substantially dependent upon the services of J. Alan Lindauer, our President and Chief Executive Officer, and Gerald T. McDonald, our Chief Financial Officer. Management is a key factor in the successful development and operation of a SBIC. J. Alan Lindauer serves as our President and Chief Executive Officer. Gerald T. McDonald serves as our Chief Financial Officer. We are highly dependant upon their services to manage our business and operations. The loss of either of their services would have a material adverse effect on our business and operations. We may be unable to locate a suitable replacement for either position. See Management.

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Risks Related to this Offering

Participants in this offering will not have the right to revoke their election to participate in this offer. Once you elect to purchase our common stock and submit your payment in connection with this offer, you may not revoke this election, even if you later learn information about us that you consider to be unfavorable.

We may opt to terminate this offering prior to the Expiration Date. Our Board of Directors may terminate this offering at any time and for any reason. If we decide to terminate the offering, we have no obligation to you except to return, without interest, your subscription payment.

Our common stock currently trades at a discount to our net asset value per share. Our shares of common stock have historically traded on the NASDAQ Capital Market at a discount to our net asset value per share, and at times the discount has exceeded 70%. We cannot assure you that this offering of our common stock will have any effect on the persistent discount to the net asset value per share experienced by our company.

If you do not fully exercise your Primary Right, you will experience dilution. As a result of the terms of the offer, shareholders who do not fully exercise their Primary Right will own, upon completion of this offer, a smaller proportional interest in our voting stock than they owned prior to the offer. In addition, because the Subscription Price may be less than the net asset value per share, the offer may result in an immediate dilution of our net asset value per share for all of our shareholders. Such dilution is not currently determinable because we do not know how many shares of common stock will be issued in the offering, what the market price of our common stock will be on the Expiration Date or what the Subscription Price will be. Such dilution will disproportionately affect non-exercising shareholders.

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COMMON STOCK RIGHTS OFFERING

Purpose of the offering

We expect to utilize the net proceeds of this offering to make additional equity and/or debt investments in new portfolio companies. At the present time, we have not identified specific future investments. Pending investment, we will hold the net proceeds of this offering in short-term, interest-bearing, investment-grade obligations.

General

Each of our shareholders as of the Record Date shall receive, at no cost, one non-transferable right (each, a Subscription Right) to purchase one share of our common stock for each share of common stock such shareholder owns as of the Record Date (the Primary Right). We intend to offer shares of our common stock to these shareholders for a price (the Subscription Price) equal to the average closing price of our common stock as of the Expiration Date. The average closing price of our common stock shall be calculated as an average of the last reported sale prices of a share of our common stock on the NASDAQ Capital Market over the 20 consecutive trading days ending on the Expiration Date. The offer to purchase our common stock will expire at 5:00 p.m., Eastern Time, on ____________, unless we decide to extend it to some later date (the Expiration Date).

We announced the offer after the close of trading on the ______________ on _________, 2005. The average closing price of our common stock on such date, as calculated above was $___________.

Because we will not determine the actual Subscription Price until the Expiration Date, shareholders who wish to purchase our common stock pursuant to their Rights will not know the Subscription Price per share at the time they elect to purchase the common stock. As a result, we are requiring that shareholders deliver an estimated Subscription Price of $______ per share. If the actual Subscription Price is lower, we will refund excess payments without interest, and if the actual Subscription Price is higher, shareholders purchasing our common stock must make an additional payment within 5 business days of the Expiration Date to get the full number of shares.

The purpose of setting the determination of the Subscription Price upon the expiration of the offer is to attract the maximum participation of shareholders in the offer, with minimum dilution to non-participating shareholders.

All questions as to the validity, form, eligibility (including time of receipt), payment and acceptance for payment of any common stock will be determined by us, in our sole discretion, which determination shall be final and binding. We reserve the absolute right to reject any and all requests for participation in this offering and to issue a lower number of shares of common stock, with our only obligation being to return any excess payment without interest. We shall be under no duty to give notification of any defects or irregularities in any request for participation in this offering, nor shall we incur any liability for failure to give any such notification.

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Over-Subscription Privilege

If you elect to purchase the maximum amount of our common stock that you are entitled to purchase pursuant to your Primary Right, you will also be entitled to subscribe, subject to allotment, to purchase additional shares of our common stock, if any, that are not purchased by our other shareholders pursuant to their Primary Right as of the Expiration Date (the Over-Subscription Privilege). If the number of shares of our common stock available for sale pursuant to the Over-Subscription Privilege is not sufficient to satisfy in full all subscriptions submitted for additional shares, we will allocate any available shares pro rata among shareholders who exercise their Over-Subscription Privilege in proportion to the number of shares each shareholder subscribing for additional shares was entitled to and elected to purchase under his or her Primary Right, up to the number of additional shares that the shareholder subscribed for pursuant to the Over-Subscription Privilege, rounded down to the nearest whole share.

Banks, brokers, trustees and other nominee holders of Rights will be required to certify to us, before any Over-Subscription Privilege may be exercised with respect to any particular beneficial owner, as to the aggregate number of Subscription Rights exercised and the number of shares of common stock subscribed for pursuant to the Over-Subscription Privilege by such beneficial owner and that such beneficial owner s Primary Right was exercised in full. We will distribute Nominee Holder Over-Subscription Forms and Beneficial Owner Election Forms to banks, brokers, trustees and other nominee holders with the Common Stock Purchase Forms.

We have been advised that many of our directors who own shares of our common stock intend to exercise all of the Rights initially issued to them. If additional shares of common stock remain after all over-subscriptions exercised by shareholders other than the directors are honored in full, the directors may, on the Expiration Date, purchase all or any of the remaining shares of common stock on the same terms offered to all shareholders.

Non-Transferability of Rights

The Rights granted in this offer are non-transferable. If you do not exercise them, you give up any right to the underlying shares of common stock.

Expiration Date of the Offering

You may elect to purchase common stock pursuant to your Primary Right and/or Over-Subscription Privilege at any time before 5:00 p.m., Eastern Time, on _________ (the Expiration Date). Our Board of Directors reserves the right to extend the date upon which the Rights expire. If you do not elect to purchase our common stock pursuant to your Rights before the time they expire, then your Rights will be null and void. We will not be obligated to honor your election to purchase common stock if we receive the documents relating to your purchase of common stock or collect your payment after the time they expire, regardless of when you transmitted the documents. See Receipt of Payment below.

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Any extension of the offer will be followed as promptly as possible by announcement thereof, and in no event later than 9:00 a.m., Eastern time, on the next business day following the previously scheduled Expiration Date. Without limiting the manner in which we may choose to make such announcement, we will not, unless otherwise required by law, have any obligation to publish, advertise or otherwise communicate any such announcement other than by making a release to the Dow Jones News Service or such other means of announcement as we deem appropriate.

Although we have no present intention to do so, we may, in the future and in our discretion, choose to make additional offerings from time to time for a number of shares and on terms which may or may not be similar to this offer. Any such future offering will be made in accordance with the Investment Company Act.

Distribution Arrangements

We do not intend to engage a dealer manager for the offer. Our officers and directors may solicit the exercise of Rights by our shareholders. The offer is not contingent on any number of Rights being exercised, and we will pay all expenses incurred in connection with the offer.

Election to Purchase Common Stock

You may elect to purchase our common stock by delivering the following to our corporate offices at or prior to the Expiration Date:

- Your properly completed and signed Common Stock Purchase Form, with any required signature guarantees, evidencing those rights with any other supplemental documentation; and

- Your payment in full of the Subscription Price for each share of common stock that you choose to subscribe for under you Primary Right and your Over-Subscription Privilege.

Method of Payment

Your payment of the Subscription Price must be made by either:

- Check or bank draft drawn upon a U.S. bank or postal, telegraphic or express money order payable to Waterside Capital Corporation ; or

- Wire transfer of immediately available funds to our account maintained for such purpose. You must contact Mr. Gerald T. McDonald, our Chief Financial Officer, at (757) 626-1111 for wiring instructions.

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If you hold our common stock through a nominee holder, you will need to have your broker, custodian bank or other nominee act for you. To indicate your decision with respect to your Rights, you should complete and return to your broker, custodian bank or other nominee the Beneficial Owner Election Form with proper payment.

Receipt of Payment

Your payment of the Subscription Price will be deemed to have been received by us only upon:

Clearance of any uncertified check;

Receipt by us of any certified check, of bank draft drawn upon a U.S. bank or any postal, telegraphic or express money order; or

Receipt of collected funds in our account designated above.

Clearance of Uncertified Checks

You should note that funds paid by uncertified personal checks may take 5 business days or more to clear. If you wish to pay the Subscription Price by an uncertified personal check, we recommend that you make payment at least 10 days in advance of the Expiration Date to ensure that your payment is received and clears by that time. **If your check does not clear before the Expiration Date, you will not receive any shares of common stock, and our only obligation will be to return your subscription payment, without interest. It is safer to use a certified or cashier s check, money order or wire transfer of funds to avoid missing the opportunity to purchase our common stock.**

You should deliver the Common Stock Purchase Form and payment of the Subscription Price, as well as any other subscription documentation as follows:

If by Mail, Hand Delivery or Overnight Delivery, to:

Waterside Capital Corporation

500 East Main Street

Suite 800

Norfolk, Virginia 23510

Attention: Secretary

For additional information, you may call Mr. Gerald McDonald, our Chief Financial Officer at (757) 626-1111 x309.

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Calculation of Common Stock Purchased

If you do not indicate the number of shares of common stock being subscribed for or do not forward full payment of the aggregate Subscription Price for the number of shares of common stock that you indicate are subscribed for, then you will be deemed to have purchased the maximum number of shares of our common stock that may be purchased for the payment that you delivered to us.

Notice to Nominee Holders

If you are a broker, a trustee or a depository for securities who holds shares of our common stock for the account of others as of the Record Date, you should notify the respective beneficial owners of the shares about the Rights offering as soon as possible to find out their intentions. You should obtain instructions from the beneficial owner with respect to the Rights by using the Beneficial Owner Election Form and instructions that we have provided to you for your distribution to beneficial owners. If the beneficial owner so instructs, you should complete the appropriate Common Stock Purchase Form and, in the case of the Over-Subscription Privilege, the related Nominee Holder Over-Subscription Form, and submit them to us with proper payment.

Notice to Beneficial Owners Whose Shares are Held by a Broker or Nominee

If you are a beneficial owner of shares of our common stock or Rights that you hold through a nominee holder, we will ask your broker, custodian bank or other nominee to notify you of this offering. If you wish to purchase our common stock in connection with this offer, you will need to have your broker, custodian bank or other nominee act for you. To indicate your decision with respect to your Rights, you should complete and return to your broker, custodian bank or other nominee the Beneficial Owner Election Form. You should receive this form from your broker, custodian or other nominee with the other Rights offering materials. We suggest that you contact your broker or other nominee to be sure that they are sending you the election form without delay. **If you are giving instructions to your nominee, you should act promptly to allow a sufficient amount of time to ensure that the nominee can act to follow your instructions on time.**

Determinations Regarding the Election to Purchase Common Stock

We will decide all questions concerning the timeliness, form and eligibility of your election to purchase our common stock. Our decisions will be final and binding. We, in our sole and absolute discretion, may waive any defect or irregularity, or permit a defect or irregularity to be corrected within such time as we may determine. We may reject the election to purchase common stock because of any defect or irregularity. Your election will not be deemed to have been received or accepted until all irregularities have been waived by us or cured by you within such time as we decide, in our sole and absolute discretion.

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We will not be under any duty to notify you of a defect or irregularity. We will not be liable for failing to give you any such notice. We reserve the right to reject your election to purchase our common stock if your election is not in accordance with the terms of this offering or in proper form. We will also not accept your election to purchase our common stock if our issuance of common stock upon your election could be deemed unlawful or materially burdensome.

Questions About Subscribing for Common Stock

You may direct any questions or requests for assistance concerning the method of subscribing for common stock, the instructions, the purchase forms or other documentation referred to herein, and requests for additional copies of this prospectus to us at the following telephone number and address:

Waterside Capital Corporation

500 East Main Street

Suite 800

Norfolk, Virginia 23510

Attention: Secretary

(727) 626-1111

Termination

We may terminate this offering at any time prior to the Expiration Date. If we terminate the offering, our only obligation to you will be to return your subscription payment to you, without interest.

No Recommendations to Holders

WE MAKE NO RECOMMENDATION TO ANY PERSON TO PARTICIPATE IN THIS OFFERING, AND WE HAVE NOT AUTHORIZED ANY PERSON TO MAKE ANY SUCH RECOMMENDATION. POTENTIAL HOLDERS ARE URGED TO EVALUATE CAREFULLY ALL INFORMATION IN THE REGISTRATION STATEMENT, CONSULT THEIR OWN INVESTMENT AND TAX ADVISORS AND MAKE THEIR OWN DECISIONS WHETHER OR NOT TO PARTICIPATE IN THIS OFFERING.

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USE OF PROCEEDS

Based on an assumed public offering price of $4.00 per share and the sale of all 1,456,675 Shares in this Offering, we will receive approximately $5.8 million, before deduction of expenses of this Offering estimated at $125,000. All the net proceeds received will be used to increase our Private Capital that will be used to make additional equity and/or debt investments in portfolio companies. As of the date of this prospectus, we have not identified any specific investments to be made with the proceeds of this offering. Pending investment in portfolio company securities, we have, and will continue to invest our otherwise uninvested cash in (i) federal governmental or agency issued or guaranteed securities that mature in 15 months or less, (ii) repurchase agreements with banks with maturities of seven days or less, the underlying instruments of which are securities issued or guaranteed by the federal government, (iii) certificates of deposit which are insured by the Federal Deposit Insurance Corporation (the FDIC) with maturities of one year or less, up to the amount of the deposit insurance, (iv) deposit accounts in an FDIC insured bank subject to withdrawal restrictions of one year or less, up to the amount of deposit insurance or (v) certificates of deposit or deposit accounts in an FDIC insured bank in amounts in excess of the insured amount if the insured bank is deemed well-capitalized by the FDIC.

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PRICE RANGE OF OUR COMMON STOCK

Our common stock is traded on the NASDAQ Capital Market under the symbol WSCC. The following table lists the high and low closing prices for our common stock and the closing sales price as a percentage of our net asset value per share:

	Net Asset Value Per Share	Closing Sales Price High	Closing Sales Price Low	Premium/(Discount) of High Sales Price to Net Asset Value Per Share	Premium/(Discount) of Low Sales Price to Net Asset Value Per Share
Year ended June 30, 2004					
First Quarter	$ 8.28	$ 4.12	$ 2.63	(50.2)%	(68.2)%
Second Quarter	8.81	4.39	3.50	(50.2)	(60.3)
Third Quarter	10.13	7.00	3.77	(30.9)	(62.8)
Fourth Quarter	9.82	7.69	5.25	(21.7)	(46.5)
Year ended June 30, 2005					
First Quarter	$ 9.81	$ 5.73	$ 4.23	(41.6)	(56.9)
Second Quarter	9.41	5.31	4.60	(43.6)	(51.5)
Third Quarter	7.81	5.58	4.70	(28.6)	(39.8)
Fourth Quarter	10.83	5.41	3.62	(50.1)	(66.6)
Year ending June 30, 2006					
First Quarter	$ 10.96	$ 4.75	$ 3.60	(56.7)	(67.2)
Second Quarter (through December 9th)	$ 10.96	$ 4.00	$ 3.85	(63.5)	(64.9)

DIVIDEND POLICY

We anticipate that all of our earnings will be retained for development and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. The payment of dividends is subject to the discretion of the Board of Directors and will depend on our results of operations, financial position, capital requirements, general business conditions, restrictions imposed by any financing arrangements, legal and regulatory restrictions on the payment of dividends and other factors the Board of Directors deems relevant.

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CAPITALIZATION

The following sets forth our equity capitalization at September 30, 2005, and, as adjusted, to give effect to our sale of the 1,456,675 shares of common stock (based on an assumed public offering price of $4.00 per share) and the application of the estimated net proceeds of such sale.

This table should be read in conjunction with the Financial Statements included elsewhere in this Prospectus.

	At September 30, 2005	
	Outstanding	**As Adjusted**
Stockholders equity:		
Preferred Stock, par value $1 per share, 25,000 shares authorized, no shares issued or outstanding or as adjusted	$	$
Common stock, par value $1 per share; 10,000,000 shares authorized, 1,456,675 shares issued and outstanding, 2,913,350 shares as adjusted	1,456,675	2,913,350
Additional paid-in capital	14,204,223	18,449,248
Net unrealized appreciation on investments	3,934,507	3,934,507
Undistributed accumulated earnings (loss)	(3,813,985)	(3,813,985)
Total stockholders equity	15,781,420	21,483,120
Total capitalization	$ 15,781,420	$ 21,483,120

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OUR COMPANY

General

We were incorporated in the Commonwealth of Virginia on July 13, 1993. We began business operations in July 1996 after receiving an SBA license and closing our initial private placement of common stock. We made our first portfolio investment in October 1996 and, as of December 12, 2005, have approximately $34.9 million in investments at fair value in 21 portfolio companies.

We are a non-diversified closed-end investment company licensed by the SBA as an SBIC under the SBA Act. We invest in equity and debt securities of small businesses to finance their growth, expansion and modernization. Our equity investments have generally been in the form of preferred stock bearing current-pay dividends. The weighted average dividend on our preferred stock investments is currently 11.95%. The weighted average annual interest rates on our loans is currently 12.39%. To date, we have made many of our investments in preferred stock because, as an SBIC, our dividend income is non-taxable. Our equity and debt financings are generally coupled with warrants to acquire common stock representing a minority interest in our portfolio companies. We seek to achieve current income from origination fees, preferred stock dividends and interest on loans, as well as long-term growth in the value of our net assets through the appreciation of our common stock positions in portfolio companies. Our main office is located at 500 East Main Street, Suite 800, Norfolk, Virginia 23510, and our telephone number is (757) 626-1111.

We expect to generally make future investments ranging from $500,000 to $2,500,000 in equity and debt securities of small businesses, although under special circumstances, our investments may be less than or greater than this range. We believe that investments of this size will be appropriate, given the size of our Private Capital (defined as eligible capital paid for capital stock and additional paid-in capital) base, and that non-traditional lenders and investors often focus on larger investments and reject attractive companies with funding needs in this range.

When evaluating potential investment opportunities, we target portfolio companies that meet certain investment criteria including potential for significant growth, experienced management teams with significant ownership interests and strong financial histories. We believe that the market for financing small businesses, either through equity or debt, is underserved by traditional sources of capital and that many of our potential competitors are burdened with overhead, administrative and regulatory structures that hinder them from competing more effectively in this market.

We have raised our Private Capital through private investments by individuals, businesses, financial institutions and governmental entities located primarily in eastern Virginia and through our January 1998 public offering. Our Private Capital includes approximately $5.5 million invested by certain accredited investors. In addition, we obtained $8,083,536 of net

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proceeds from our initial public offering in February 1998. To fund our equity investments and debt financings, we have used our private and public offering proceeds as well as borrowed funds from the SBA (SBA Debentures) which are available to us for up to 10 years. At September 30, 2005, we have drawn down debentures totaling $25.4 million payable to the SBA. The $21,400,000 million outstanding debentures bear interest at a weighted average fixed interest rate of 7.93%, including an annual service fee of 1.0%, and mature between March 1, 2009 and September 1, 2011. The debentures require semi-annual payments of interest only, with all principal due upon maturity. During the first five years outstanding, the SBA Debentures are subject to a prepayment penalty. In addition to the periodic interest rate described above, we pay a 1.0% one-time fee on all SBA Debentures at the time of approval by the SBA and a 2.5% one-time fee on amounts actually drawn by us.

Strategy

We are currently seeking opportunities to provide growth capital financing to small businesses. Primarily through our experience in business and with financial institutions, management and members of the Executive Committee of our Board of Directors have developed a level of expertise in identifying and developing new investment opportunities in our market. When evaluating potential investment opportunities, we target portfolio companies that meet certain criteria, including potential for significant growth, experienced management teams with a significant ownership interest and strong financial histories. We believe the market for small commercial loans is underserved by traditional lending sources. Traditionally, small businesses have relied on commercial banks to provide debt financing to fund growth. In the latter half of the 1980s and the early 1990s, funds from these traditional lending sources diminished as commercial banks consolidated market share and sought to limit both credit exposure and administrative expense associated with monitoring numerous small company loans. We also believe that many of our competitors are burdened with overhead, regulatory and administrative structures that hinder them from competing more effectively in our market. As a result of these fundamental changes, a significant opportunity has developed for nontraditional lenders to provide not only debt financing to, but also equity infusions in, small companies, creating the potential for attractive risk-adjusted returns.

Our Investment Objective

The investing formats of SBICs can range from making long-term secured and unsecured loans to providing equity capital. We have utilized, and anticipate continuing to utilize both types of investments to achieve a balanced portfolio of both equity and debt investments structured to meet the individual needs of, and the investment opportunities associated with, our portfolio companies.

With each investment, we seek to achieve current income through origination fees, preferred stock dividends and loan interest and long-term growth in the value of our assets through appreciation of our common stock interests in portfolio companies. We attempt to structure our asset portfolio for relative safety and soundness, while, at the same time, provide for equity features that will permit us to achieve returns commensurate with our risks.

Our management believes that an attractive return can be obtained on appropriately structured investments in small businesses, provided that the principals of such business contribute the requisite skill and dedication.

Selection of Investment Opportunities

We have invested, and expect to continue investing, in a wide range of businesses including manufacturing and service firms. Since making our first investment in late 1996, we have identified certain key elements for investing in emerging growth small businesses. We initiate our investment decisions by analyzing traditional criteria for making any equity or debt investment or granting any credit: character, collateral, growth potential, capacity to repay, financial and credit history and other factors. After an initial screening based on these factors, management recommends to the Executive Committee investments in those small businesses it believes will succeed and contribute to our profitability. In general, although obviously involving substantially more risk, providing growth capital to small businesses can generate a higher return on investment because these companies often have higher growth rates of revenues and profits than larger, more established firms. We generally have not focused on making loans to, or investments in start-up companies that may have difficulty making current dividends or interest payments, although most investments are in early-stage companies, and we expect to continue to make such investments in the future.

Traditional lenders require certain standards before affirmatively considering a loan. Among others, these standards include debt service coverage ratios, profit history, adequate working capital and collateral security. We include these factors in our decision-making process, but also attribute significant weight to products, market size, growth potential, capability of management and exit strategies for the equity portion of our investment. To identify an exit strategy, our management carefully studies the portfolio company s growth potential, as well as historical financial performance.

Settlement of Investments

We have made, and expect to continue to make, our equity investments with the intention of liquidating the investment for cash within five to seven years, although situations may arise in which we may hold equity securities for longer periods. Our loans are generally made for a minimum of five years. We expect that a successful investment will result in the redemption of preferred stock with dividends or the repayment of a loan with interest and a gain on the sale of the portfolio company s common stock, generally through the exercise of warrants acquired in connection with the investment or the conversion of convertible securities.

Preferred stock that we purchase generally bears a put option, exercisable after five years, requiring the portfolio company to repurchase the shares at par, together with any unpaid dividends. The warrants we acquire often carry a similar put option, also exercisable generally after five years, requiring a repurchase of the underlying common stock at fair market value. The warrants typically also contain anti-dilution provisions and are detachable and transferable.

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Before making any investment, we analyze the potential for the portfolio company to experience a liquidity event that will allow us to recover the purchase price of our preferred stock investments or to have our loan repaid and to realize appreciation in our common stock positions. Liquidity events include not only the exercise of put options or loan maturity, but also an initial public offering or the sale, merger or recapitalization of the portfolio company.

Portfolio Companies

As of September 30, 2005, the company has approximately $34.9 million outstanding in loans and investments in twenty-one portfolio companies. A brief description follows:

AmeriComm Direct Marketing, Inc. This Norfolk, Virginia company provides single-source direct marketing and business communication services. We currently own 4% of the membership interest with certain put rights at a third-party appraised value.

Answernet, Inc. This Princeton, New Jersey company provides call center and professional answering, outsource contact center and fulfillment service. We currently own 4% of the common stock in the form of stock warrants.

Avery Holdings, LLC This Glenview, Illinois company owns 11% of the outstanding common stock of Billing Services Group, LLC. Billing Services Group, LLC is a publicly traded company on the London Exchange that operates as a telecommunications service company with multiple service offerings, including billing and collection service for inter-exchange carriers and long-distance resellers and intelligent message communication service to the travel, hospitality, transportation, and telecommunications call center sector. We have a loan receivable of $680,000 at an 8% rate, maturing December 2006. Additionally, we invested $1,250,000 in convertible preferred stock with a 12% coupon. We own 12.98% of the membership interest in Avery assuming full conversion.

Crispies, Inc. This Gloucester, Virginia based apparel retailer markets the Peace Frogs brand. Branded clothing items are distributed through special displays in shopping malls, through catalog sales, and through an online storefront. We currently own 13% of the common stock through stock warrants.

Digital Square, LLC This Norfolk, Virginia based company has a new way of buying software products that involves both the client product and online presence. We currently own a 60% membership interest in the company.

Diversified Telecom, Inc. This Princeton, New Jersey company provides call center professional answering, outsource contact center, and fulfillment services. We currently own 31.1% of the stock in the corporation, in the form of common stock and warrants.

EPM Development Systems This Midlothian, Virginia based company, trading under the name New Life Designs, manufactures and distributes technologies and

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products for the medical and fitness markets. The focus of these products has been in the area of cardio respiration and sleep disorders. We currently have outstanding a debt security for $1.5 million, a bridge note for $173,000 and 6.24% of the common stock outstanding in the form of stock warrants.

Eton Court Asset Management, Ltd. This Alexandria, Virginia company was formed for the purpose of acquiring small and mid-sized asset management firms. Their primary goal is to build a regional investment company. We have multiple investments in the company consisting of debt securities, preferred stock, and common stock for 36.25% of the outstanding.

Fairfax Publishing Company, Inc. This Vienna, Virginia based company publishes the Senior Source and the Senior Living Resource magazines that provides readers and their families with information with informative solutions for retirement needs. These magazines are available in Charlotte, NC, the Triangle area of NC, the Triad area of NC, Middle and SC, and upstate SC. We invested $600,000 in preferred stock and additionally obtained 20.3% of the outstanding common stock in the form of stock warrants.

FireKing International, Inc. This New Albany, Indiana company is engaged in the design, manufacture, and sale of fire-proof fire cabinets, fire-proof safes, electronically operated combination locks, and cash handling safes. These products are sold both domestically and internationally. We invested $2 million in a debt security carrying a 13% coupon maturing on May 31, 2010. We additionally own approximately 0.5% of the outstanding common stock in the form of stock warrants.

JTI, Inc. This Norfolk, Virginia company provides full-scale software localization, technical document translation and web globalization services in over 40 languages, specializing