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SHOPNET COM INC  
Form 10QSB  
May 20, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-QSB  
(Mark One)

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

For the quarterly period ended March 31, 2003,

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-28690  
SHOPNET.COM, INC.  
(Exact Name of Small Business Issuer as Specified in its Charter)

Delaware

13-3871821

-----  
(State or Other Jurisdiction of (IRS Employer Identification No.)  
Incorporation or Organization)

112 West 34th Street, Suite 902, New York, New York 10120  
(Address of Principal Executive Offices)

(212) 967-8303  
(Issuer's Telephone Number, Including Area Code)

14 East 60th Street, Suite 402, New York, NY 10022

-----  
(Former Name, Former Address, and Former Fiscal Year, if Changed Since Last  
Report)

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares of each of the issuer's classes of common  
equity outstanding as of the latest practicable date: Common Stock, par value  
\$.001 par value: 8,067,462 shares outstanding as of May 15, 2003.

SHOPNET.COM, INC. AND SUBSIDIARIES

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SHOPNET.COM, INC. AND SUBSIDIARIES  
Consolidated Balance Sheets  
As of March 31, 2003 and June 30, 2002

ASSETS

Current assets:

Cash  
Accounts receivable, net  
Other receivables  
Inventory  
Prepaid expenses  
Advances to officer

Total current assets

Property and equipment, net  
Film production and distribution costs, net  
Costs in excess of net assets of business acquired  
Investments in movie ventures

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Deferred tax asset-non-current  
Other assets

Total assets

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

Due to factor  
Accounts payable  
Loan payable  
Accrued expenses  
Capital lease obligations current portion  
Other taxes payable  
Deferred tax liability

Total current liabilities

Long term liabilities:

Capital lease obligations-net of current portion  
Total long term liabilities

Total liabilities

Commitments and contingencies

Stockholders' equity

Common stock- \$.001 par value, 20,000,000 shares authorized, 8,067,462  
shares issued and outstanding at March 31, 2003 and 7,472,224 shares  
issued and  
outstanding at June 30, 2002  
Capital in excess of par value  
Accumulated deficit

Total stockholders' equity

Total liabilities and stockholders' equity

The accompanying notes should be read in conjunction with the consolidated  
financial statements

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SHOPNET.COM, INC. AND SUBSIDIARIES  
Consolidated Statement of Operations and Comprehensive Income (Loss)  
(Unaudited)

Nine Months Ended		Three Months
March 31, 2003	March 31, 2002	March 31, 2003

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	-----	-----	-----	
Net sales .....	\$ 5,849,229	\$ 6,313,067	\$ 5,098,551	\$
Cost of sales .....	3,688,757	3,927,537	3,441,519	
	-----	-----	-----	
Gross profit .....	2,160,472	2,385,530	1,657,032	
	-----	-----	-----	
Expenses:				
Selling, general, and administrative .....	2,053,631	2,007,246	1,071,884	
Amortization of costs in excess of net assets of business acquired .....	--	53,214	--	
	-----	-----	-----	
Total expenses .....	2,053,631	2,060,460	1,071,884	
	-----	-----	-----	
Income (loss) before other income (expenses) and provision for income taxes .....	106,841	325,070	585,148	
	-----	-----	-----	
Other income (expenses):				
Equity in earnings (loss) of affiliate .....	(15,928)	(595)	(15,928)	
Write down of film costs .....	--	--	--	
Rental income .....	--	9,050	--	
Interest and financial expense .....	(355,258)	(357,941)	(265,073)	
Interest income .....	1,713	11,008	777	
	-----	-----	-----	
Total other income (expense) .....	(369,473)	(338,478)	(280,224)	
	-----	-----	-----	
Income (loss) before provision for income taxes	(262,632)	(13,408)	304,924	
Provision (benefit) for income taxes .....	--	--	--	
	-----	-----	-----	
Net income (loss) .....	(262,632)	(13,408)	304,924	
	-----	-----	-----	
Other items of comprehensive income (loss) .....	--	(6,350)	--	
	-----	-----	-----	
Comprehensive (loss) .....	\$ (262,632)	\$ (19,758)	304,924	\$
	-----	-----	-----	
Basic:				
Net income loss per share .....	\$ (.03)	\$ (Nil)	\$ .04	\$

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	=====	=====	=====
Weighted average number of common shares outstanding .....	7,802,912	7,472,244	8,067,462
	=====	=====	=====

The accompanying notes should be read in conjunction with the consolidated financial statements

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SHOPNET.COM, INC. AND SUBSIDIARIES  
 Consolidated Statement of Stockholders' Equity  
 For The Six Months Ended December 31, 2002  
 (Unaudited)

	Common Shares	Stock Amount	Additional Paid-in Capital	Accumulated Deficit
	-----	-----	-----	-----
Balances at June 30, 2002 (Audited)	7,472,224	\$ 7,472	\$ 6,638,852	\$ (4,453,741)
August 28, 2002, issuance of 5% Convertible debentures	-	-	-	-
Nov. 6, 2002-Conversion of debentures into 595,238 shares	595,238	595	14,405	
Net loss (Unaudited) for the nine months ended March 31, 2003				(262,632)
Balances at March 31	8,067,462	\$8,067	\$ 6,653,257	\$ (4,716,373)
	=====	=====	=====	=====

The accompanying notes should be read in conjunction with the consolidated financial statements

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SHOPNET.COM, INC. AND SUBSIDIARIES  
 Consolidated Statement of Cash Flows  
 For The Nine Months Ended March 31, 2003 And 2002  
 (Unaudited)

Cash flows from operating activities:

Net loss

Adjustments to reconcile net income to net cash used in operating activities:

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Equity in loss of affiliate  
Amortization and depreciation

Decrease (increase) in:  
Accounts receivable  
Other receivables  
Inventory  
Prepaid expenses  
Advances to officer  
Other assets  
Marketable securities affiliate  
Increase (decrease) in:  
Due to factor  
Accounts payable  
Accrued expenses  
Other taxes payable

Net cash used in operating activities

Cash flows from investing activities:  
Acquisition of property and equipment

Net cash used in investing activities

Cash flows from financing activities:  
Principal payments on capital leases  
Issuance of stock  
Issuance of new capital leases  
Loans Payable

Net cash used in financing activities

Net decrease in cash and restricted cash

Cash and restricted cash, beginning of period

Cash and restricted cash, end of period

Supplemental disclosure of cash flow information: cash paid during the period for :

Interest

Income taxes

The accompanying notes should be read in conjunction with the consolidated financial statements

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## SHOPNET.COM, INC. AND SUBSIDIARIES

### NOTES TO FINANCIAL STATEMENTS

#### NOTE 1- ORGANIZATION

Shopnet.com, Inc. ("Shopnet" or the "Company") was incorporated in the State of Delaware on December 1, 1995 under the name of Hollywood Productions, Inc. It was formed for the purpose of acquiring screenplays and producing motion pictures. On May 10, 1999, the Company filed an amendment to its Articles of Incorporation to change its name to Shopnet.com, Inc. On May 12, 1999, Shopnet incorporated a new wholly owned subsidiary, Hollywood Productions, Inc. ("Hollywood"), to which the Company assigned all of its film rights. Accordingly, Shopnet is considered a holding company. During September 1996, simultaneously with the completion of its Initial Public Offering ("IPO"), Shopnet acquired all of the capital stock of Breaking Waves, Inc. ("Breaking Waves"). Breaking Waves designs, manufactures, and distributes private and brand name labels of children's swimwear nationally. As of June 30, 2002, Shopnet and all of its subsidiaries changed their financial year end from December 31 to June 30.

#### NOTE 2- INTERIM RESULTS AND BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements as of March 31, 2003 and for the six month periods ended March 31, 2003 and March 31, 2002 and for the three month periods ended March 31, 2003 and March 31, 2002 have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Items 303 and 310 of Regulation S-B. In the opinion of management, the unaudited financial statements have been prepared on the same basis as the annual financial statements and reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the financial position as of March 31, 2003 and the results of operations and cash flows for the six month periods ended March 31, 2003 and March 31, 2002 are not necessarily indicative of the results to be expected for any subsequent quarter or the entire fiscal year. The balance sheet at June 30, 2002 has been derived from the audited financial statements at that date.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the Securities and Exchange Commission's rules and regulations. The Company believes, however, that the disclosures in this report are adequate to make the information presented not misleading in any material respect. The accompanying consolidated financial statements should be read in conjunction with the audited financial statements of Shopnet.com, Inc. and Subsidiaries as of June 30, 2002 and for the year then ended and notes thereto included in the Company's report on Form 10-KSB filed on October 15, 2002.

The Company in the quarter ended March 31, 2003 has

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implemented a number of initiatives which it believes will reduce its costs of operations and alleviate in the following six months its working capital deficiency. In particular, the Company believes that the repayment of its indebtedness to Century (See Note 7) and the recent reductions in interest rates will reduce interest expense.

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### SHOPNET.COM, INC. AND SUBSIDIARIES

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 2- INTERIM RESULTS AND BASIS OF PRESENTATION (continued)

In December 2001, the Company consolidated all of its operation's in the New York metropolitan region into one new facility (See Note 9(a) ), creating a savings through synergies in office expense and decrease in rent and salaries. The Company has, also, recently refocused its sales efforts, to the extent possible, to eliminate unprofitable or low margin sales and has had improved sales and orders for the current fiscal year.

##### NOTE 3- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

###### a) Recently adopted accounting principles - Film accounting

Pursuant to SFAS no. 139, the Company adopted Statement of Position ("SOP") 00-2, "Accounting by Producers or Distributors of Films" during the nine months ended March 31, 2003. SOP 00-2 established new film accounting standards, including changes in revenue recognition and accounting for advertising, development and overhead costs. Specifically, SOP 00-2 requires advertising costs for theatrical and television products to be expensed as incurred. This compares to the Company's previous policy of first capitalizing these costs and then expensing them over the related revenue streams. In addition, SOP 00-2 requires development costs for abandoned projects and certain indirect overhead costs to be charged to film costs, which was required under the previous accounting rules, SOP 00-2 also in other areas, such as revenue recognition, generally are consistent with the Company's existing accounting policies. SOP 00-2 was adopted as of July 1, 2001, and had no effect on the Company's consolidated results of operations, financial position or cash flows.

###### b) Recently issued accounting pronouncements

The Company does not believe that any recently issued but not yet effective accounting standards, have a material effect on the Company's consolidated financial position, results of operations or cash flows except for the effect of adoptions of SFAS No. 142, "Goodwill and Other Intangible assets". It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. SFAS 142 also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial



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statements. The Company adopted the provisions of this new standard beginning with the first quarter of 2002.

c) Earnings per share:

Basic earnings (loss) per share is computed by dividing net income (loss) income attributable to common shares, by the weighted average number of common shares outstanding during each period. Diluted earnings (loss) per share is similar to basic earnings (loss) share, except that the weighted average number of common shares outstanding is increased to reflect the dilutive effect of potential common shares as if they had been issued.

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### SHOPNET.COM, INC. AND SUBSIDIARIES

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 4- ACQUISITION OF BREAKING WAVES, INC.

Pursuant to a stock purchase agreement dated May 31, 1996 (the "Agreement"), on September 24, 1996, the Company issued 110,000 shares of common stock in exchange for all of the issued and outstanding capital stock of Breaking Waves. The transaction was accounted for using the purchase method of accounting. As a result of the transaction, excess of cost over net assets acquired totaling \$1,064,283 was recorded and was being amortized over the useful lives of the related assets which was fifteen years.

Effective for the year ended June 30, 2002, the Company adopted FAS 142 "Goodwill and Other Intangible Assets". Under FAS 142, goodwill and indefinite lived intangible assets are no longer amortized but are reviewed annually for impairment. Goodwill is tested for impairment at the reporting level. Under FAS 142, the fair value of a reporting unit is compared to its carrying amount, including goodwill. If the book value (carrying amount) is below the fair value assessment, there will be no impairment or loss. If the fair value is below the book value (carrying amount), the Company needs to perform a second test to determine the gap between the impaired fair value of goodwill and its carrying amount.

The Company had determined that no impairment existed as of March 31, 2003. Accordingly, the book value was not further written down.

##### NOTE 5- INVESTMENTS IN MOVIE VENTURES

a) Battle Studies

Pursuant to a co-production agreement dated April 17, 1998 with North Folk Films, Inc., the Company invested through March 31, 2003, \$217,500 for a 50% interest in a new entity, Battle Studies Productions, LLC ("Battle Studies") a limited liability company. Battle Studies is accounted for as a joint

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venture in order to co-produce motion pictures and to finance the costs of production and distribution of such motion pictures. The joint venture retains all rights to the motion pictures, the screenplays, and all ancillary rights attached thereto.

b) The Girl

Pursuant to an agreement dated July 1, 1999 with Artistic License Films Inc., Hollywood invested through March 31, 2003 \$35,000 for a 22.533% interest in a new entity, The Girl, LLC ("The Girl") a limited liability company. In return for its participation in The Girl, Hollywood is entitled to receive a non-contested, non-dilutable 22.533% ownership interest in The Girl, a recoupment of its investment on no less favorable terms than any other investor and 22.533% of 100% of any contingent compensation which shall be actually received by The Girl. The Girl retains all rights to the motion pictures, the screenplays, and all ancillary rights attached thereto.

The Company accounts for the investments in Battle Studies and The Girl under the equity method. For the nine months ended March 31, 2003 and 2002, the Company recorded an equity loss of \$13,928 on this investment.

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### SHOPNET.COM, INC. AND SUBSIDIARIES

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 6- MARKETABLE SECURITIES- AFFILIATE

Breaking Waves owned 1,270,000 unregistered common shares of Play Co. Toys & Entertainment Corp. ("Play Co."), a toy retailer and a publicly traded company whose Chairman of the Board was also the President of Shopnet and Breaking Waves.

Breaking Waves' ownership percentage was approximately 1.5% of Play Co. The investment in Play Co. was accounted for under the requirements of SFAS No. 115, "Accounting for Certain investments in Debt and Equity Securities." Under SFAS 115, the securities were considered available for sale and therefore the carrying value was based on the fair market value of the securities at March 31, 2003 and 2002 which amounted to \$0 as of both dates.

The change in the fair market value of the securities during the periods are recorded as an unrealized gain or loss as a component of comprehensive income. The Company pledged such shares as collateral for a standby letter of credit in connection with Breaking Waves entering into a new factoring agreement with Century Business Credit Corporation ("Century") and were therefore considered non-current (See Note 7).

On March 28, 2001 Play Co. filed for protection under Chapter Eleven of the United States Code with the United States Bankruptcy Court for the Southern District of New York. The

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filing was converted into a Chapter Seven filing on August 28, 2001.

### NOTE 7- DUE TO FACTOR

#### Century Business Credit Corporation

On or about September 12, 2000, Breaking Waves entered into a factoring and revolving inventory loan and security agreement ("factoring agreement") with Century Business Credit Corporation ("Century") to sell its interest in all present and future receivables without recourse. Breaking Waves submits all sales offers to Century for credit approval prior to shipment, and pays a factoring commission of .75% of receivables sold.

Century retains from the amount payable to Breaking Waves a reserve for possible obligations such as customer disputes and possible credit losses on unapproved receivables. Breaking Waves may take advances of up to 85% of eligible receivables and up to 50% of the value of finished goods in inventory, with interest payable monthly at the rate of 1 3/4% over prime.

Pursuant to the terms of a Reimbursement and Compensation Agreement, a trust ("Trust"), the beneficiary of which is a relative of the Company's President and Chief Executive Officer ("CEO") and a relative of a principal stockholder, pledged assets as collateral for securing a \$250,000 letter of credit to replace a portion of a letter of credit previously pledged by the Company.

Accordingly, on December 20, 2000 the original agreement with the factor was amended to allow such replacement of collateral. Breaking Waves' Loan and Security Agreement with Century dated December 20, 2000 requires the provision of one or more letters of credit in the aggregate amount of \$1,150,000 to partially secure the line of credit. On September 15, 2001, Century required the Company to increase the amount of collateralized standby letters of credit by \$300,000 raising such amount to \$1,450,000.

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#### SHOPNET.COM, INC. AND SUBSIDIARIES

#### NOTES TO FINANCIAL STATEMENTS

### NOTE 7- DUE TO FACTOR

#### Century Business Credit Corporation

On May 3, 2001, the Agreement with the Trust was amended so that the letter of credit secured by the Trust was increased to \$400,000. As a condition of the amendment, the Company entered into a guarantee agreement with Gal Capital Corp., whose President is a relative of the Company's President and CEO and a principal stockholder of the Company to act as guarantor of the obligation to the Trust up to \$400,000 in exchange for a fee of \$42,500 which the Company paid on May 3, 2001. The amended letter of credit expired on September 1,

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2001 and was subsequently amended on September 15, 2001.

On September 15, 2001, the Amended and Restated Reimbursement and Compensation Agreement was entered into and further amended the agreement with the Trust, so that the letter of credit secured by the Trust was increased to \$750,000. The amended letter of credit expired on September 1, 2002 but can be extended year to year at the Company's option for a period of ten years. On September 1, 2002, the letter of credit was extended. Breaking Waves agreed to reimburse the Trust for any and all losses, fees, charges and expenses to the Trust in the event the letter of credit is called by Century and / or the issuing bank demands reimbursement from the Trust. Breaking Waves' obligations are guaranteed by the Company in addition to being secured by a first security interest in all of the assets of the Company and a subordinate security interest in all of the assets of Breaking Waves.

In December 2002, Breaking Waves entered into a Reimbursement and Compensation Agreement with TERE, S.A., a Swiss entity. As a consequence of Century being unwilling to grant credit to Breaking Waves unless it received one or more letters of credit satisfactory to it as well as cash collateral to partially secure the line of credit in such amounts as it deems appropriate, the Trust reduced the letter of Credit secured by it to \$500,000. TERE, S.A. agreed to loan Breaking Waves the sum of \$250,000 represented by a promissory note. The funds were deposited as cash collateral with Century to replace the reduced portion of the letter of credit secured by the Trust.

All obligations under this agreement are guaranteed by the Company and are secured by a security interest in all of the Company's assets.

As compensation, Breaking Waves paid all interest received from or credited to it by Century on the sums deposited pursuant to the Cash Collateral Agreement when received.

The term of the loan is for ten years.

ARC has agreed to pay to TERE, interest at the rate of 8% per annum on quarterly basis.

On September 15, 2001, the Company entered into a Reimbursement Agreement with relatives of a principal stockholder who is related to the President and CEO of the Company ("RAYA") who pledged assets as collateral for securing a \$300,000 letter of credit as additional collateral to secure Breaking Waves' Loan and Security Agreement with Century. Absent any default, the letter of credit will remain in effect for ten years. The Agreement is guaranteed by Shopnet under a separate Security Agreement dated September 15, 2001.

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SHOPNET.COM, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

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NOTE 7- DUE TO FACTOR

Century Business Credit Corporation (continued)

In exchange for the letters of credit, the Trust and RAYA will proportionately, based on the total outstanding letters of credit, receive a fee of one and one quarter percent (1-1/4%) of net sales of Breaking Waves through June 30, 2002 and thereafter one and three quarters percent (1-3/4%) of net sales through September 30, 2011. In October 2001, the Trust and RAYA received advance payments to be applied towards future fees of \$24,500 and \$12,250, respectively. All future payments are payable forty five days after the close of each fiscal quarter. The fees are effective October 1, 2001.

In September 2001, the Company and Breaking Waves retained Arc Financial Corp. ("ARC"), a British Virgin Island company, for a ten year term to provide financial consulting services.

Pursuant to the terms of a consulting services. Pursuant to the terms of a consulting agreement ("ARC Consulting Agreement"), ARC was retained to assist the Company in the acquisition of financing to acquire inventory and for other corporate purposes ("Financing"), as well as consult with the Company with regard to its ongoing operations, promote sales of Breaking Waves' products and improving production.

Pursuant to the terms of the ARC Consulting Agreement, the Company and Breaking Waves agreed to compensate ARC (i) an annual fee of \$20,000 ("Base Fee") and (ii) a percentage of annual net sales in the amount of 1-1/4% through June 30, 2002 and 1-3/4% of net sales for each year of the term thereafter through September 30, 2011 ("ARC Percentage Fee"), payable 45 days after the closing of each fiscal quarter.

In October 2001, ARC received (I) a lump sum payment of \$209,000 reflecting full advance payment of the Base Fee and (ii) \$36,750 reflecting advance payment of the Arc Percentage Fee. The agreement with Arc expires September 30, 2011. The Company and Breaking Waves are entitled to terminate the ARC Consulting Agreement any time after September 30, 2006, in which event all prepaid fees are forfeited.

The following table summarizes the percentage due each party, as noted above, as a percentage of net sales for the three months ended March 31, 2003:

	% of Net Sales	Amount
	-----	-----
RAYA	0.58	\$ 29,572
ZAT	1.16	59,143
ARC	1.75	89,225
	-----	-----
	3.49	\$177,940
	=====	=====

Interest expense related to the factor agreement totaled \$144,027 and \$190,908 for the nine months ended March 31, 2003 and 2002, respectively. Century has a secured interest in

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Breaking Waves' inventory as collateral for the advances. As of March 31, 2003, the net advances to Breaking Waves from Century amounted to \$1,364,327.

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SHOPNET.COM, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

NOTE 8- NOTE PAYABLE

On November 8, 2002, the Company borrowed the sum of \$50,000 in the form of a promissory note from Amigal Salit, Ltd., an unrelated party. The note which is non-interest bearing is due on or before August 15, 2003.

On the same date, the Company entered into an agreement with ARC Financial Corporation, whereby the Company using the proceeds received from Amigal Salit, Ltd., agreed to pay \$50,000 as an advance against fees to be owed by Breaking Waves to ARC Financial Corporation in connection with Breaking Waves obligation to pay certain fees to ARC as part of a consulting agreement as described in Note 7 (b) herein.

NOTE 9- COMMITMENTS AND CONTINGENCIES

a) Lease commitments

Shopnet and Breaking Waves jointly share their administrative offices under a lease agreement signed July 2001 by Breaking Waves. Shopnet is provided office space by Breaking Waves on a rent-free basis. The lease agreement expires on September 30, 2007. Annual rent under this lease is \$84,915 through December 31, 2004 and \$97,560 for the remainder of the lease period. Additionally, Breaking Waves leases an offsite office for one of its designers on a month to month basis with annual payments approximating \$13,200.

The approximate annual future minimum rentals under non-cancelable operating lease signed by Breaking Waves are as follows:

For the fiscal year ended June 30:

2003  
2004  
2005  
2006  
2007  
Thereafter

\$  
-----  
\$  
=====

Rent expense for the nine months ended March 31, 2003 and 2002 amounted to \$81,646 and \$94,508, respectively.

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b) Significant vendors and customers

Breaking Waves purchases 100% of its inventory from three vendors, two in Indonesia (74%) and the other in the Republic of Korea (26%). Breaking Waves believes other sources and vendors are available and that it is not dependent exclusively on these vendors. For the three months ended March 31, 2003 Breaking Waves had two customers, which comprised approximately 28%, of net sales. For the nine months ended March 31, 2002, Breaking Waves had 2 customers which compromised 43% of net sales.

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### SHOPNET.COM, INC. AND SUBSIDIARIES

#### NOTES TO FINANCIAL STATEMENTS

#### NOTE 9- COMMITMENTS AND CONTINGENCIES

c) Seasonality

Breaking Waves' business is considered seasonal with a large portion of its revenues and profits being derived between December and April. Each year from April through October, Breaking Waves engages in the process of designing and manufacturing the following season's swimwear lines, during which time it incurs the majority of its production costs with limited revenues and also engages in the sale of product at negative gross margins to remove slow moving items and decrease its carrying cost.

d) License agreements

During June 2000, Breaking Waves entered into a license agreement with an effective date of November 1, 2001 with Gottex Models Ltd., as Israeli corporation and Gottex Models (USA) Corp., a New York corporation for the use of the trademark "Gottex" in the United States of America for children's swimwear. The agreement calls for a royalty fee of 7% of net sales with guaranteed minimum annual royalties of \$70,000 to \$140,000 over the life of the agreement. Breaking Waves recorded royalties under the agreement totaling \$113,019 and \$68,430 for the nine months ended March 31, 2003 and 2002, respectively.

e) Co-production and property purchase agreements

Pursuant to co-production and property purchase agreements dated March 15, 1996, as amended, the Company acquired the rights to co-produce a motion picture and to finance the costs of production and distribution of such motion picture with the co-production. The Company retains all rights to the motion picture with the co-producer agreeing to finance \$100,000 of the cost of production. The Company retains all rights to the motion picture, the screenplay, and all ancillary rights attached thereto. The motion picture was completed during the latter part of 1996 and, accordingly, the Company commenced

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the marketing and distribution process.

As of March 31, 2003, the Company invested \$1,971,956 for the co-production and distribution of such motion pictures whereas the co-producers have invested \$100,000. For the nine months ended March 31, 2003 and 2002, the Company derived no revenue from the motion picture and amortized no film costs.

For the nine months ended March 31, 2003 and 2002 the Company has not written down its film production and distribution costs, as the carrying value of the asset equals its estimated net realizable value.

f) Litigation

On or about June of 2000, an action was brought in the Queens County Supreme Court against the Company and several others claiming, among other things, that the Company allegedly breached a contract and engaged in fraudulent statements (including supposedly promising the plaintiff options and then not allowing the plaintiff to exercise these options).

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### SHOPNET.COM, INC. AND SUBSIDIARIES

#### NOTES TO FINANCIAL STATEMENTS

NOTE 9- COMMITMENTS AND CONTINGENCIES (continued)

The plaintiff seeks, among other things, compensatory damages in the amount of \$497,500, punitive damages in the amount of \$995,000, together with costs and attorney's fees. The Company intends to contest the action vigorously and believes that such claims against it are baseless and without merit.

NOTE 10- STOCKHOLDERS' EQUITY

a) Warrants

- i) Initially, each Warrant issued in the initial public offering of September 24, 1996 entitled the holders thereof to purchase one share of the Company's common stock at an exercise price of \$6.50 per share, until September 9, 2002. On August 31, 2002, the Company extended the term of its warrants by 18 months, the Warrants will now expire on March 10, 2003. On June 23, 1997, the Board of Directors approved a reduction in the exercise price of the Warrants from \$6.50 to \$3.00. On February 5, 1998, the Company affected a one for three reverse split of the Company's common stock.

Accordingly, the Company adjusted the terms of the Warrants to reflect the reverse split such that exercise of three Warrants would entitle the holder to purchase one share of common stock at an exercise price of \$9.00. Giving effect to the January 1999



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100% common stock dividend, the January 2001 10% common stock dividend and the May 2001 20% common stock dividend, the warrants have been cumulatively adjusted such that the exercise of each warrant at an exercise price of \$3.41 purchases .88 of a share of common stock.

- ii) On April 15, 1998, the Company's Board of Directors authorized the distribution of warrants to all shareholders of the Company's common stock as of May 8, 1998. Pursuant to the distribution, each shareholder of record will receive one warrant to purchase one share of common stock at an exercise price of \$4.00 per share. The warrants, which are exercisable for a period of three years, commencing one year after issuance and receipt by shareholder, shall be issued and distributed once the Company has file a registration statement for same and same has been declared effective by the Securities and Exchange Commission. The Company to date has not filed the registration statement.

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### SHOPNET.COM, INC. AND SUBSIDIARIES

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE - 11 RELATED PARTIES TRANSACTIONS

- a) For the nine months ended March 31, 2003 and 2002 financial consulting fees were paid to a corporation and an individual who are related to the Company's President and CEO amounting to \$18,725 and \$17,445, respectively.
- b) During October 1996, pursuant to two promissory notes, the Company loaned two of its officers a total of \$87,000 bearing interest at six and one-half percent (6 1/2) payable over three years. As of March 31, 2003, the unpaid portion amounted to \$37,000, which has been classified as current. As of March 31, 2003, the Company's President was also advanced additional funds totaling \$3,000 which are non-interest bearing and due on demand and are classified as current.

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### SHOPNET.COM, INC. AND SUBSIDIARIES

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE - 12 SEGMENT INFORMATION

The Company's operations have been classified into two segments: swimwear sales and film productions. These operating segments were

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based on the nature of the projects and services offered. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and assess performance. The Company's CEO has been identified as the chief decision maker. The Company's chief operating decision maker directs the allocation of resources to operating segments based on the profitability and cash flow of the respective segments.

	Nine Months Ended March	
	2003	
	Segment	Consolidated
<b>Sales:</b>		
Swimwear sales	\$5,849,229	\$
Film production	-	
<hr style="border-top: 1px dashed black;"/>		
Total sales		\$ 5,849,229
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<b>Operating income (loss):</b>		
Swimwear sales		\$ 322,638
Film production		(2,000)
<hr style="border-top: 1px dashed black;"/>		
Total operating income (loss)		\$ 320,638
<hr style="border-top: 1px dashed black;"/>		
<b>Corporate:</b>		
General and administrative expense		\$ (216,799)
<hr style="border-top: 1px dashed black;"/>		
(Loss) equity in earnings of affiliate		(13,928)
Amortization expense		-
Interest income		1,713
Interest and finance expense		(335,258)
Other		-
<hr style="border-top: 1px dashed black;"/>		
Loss from operating before (benefit)		(262,632)
Provision for income tax		-
<hr style="border-top: 1px dashed black;"/>		
Net (loss) income		\$ (262,632)
<hr style="border-top: 3px double black;"/>		

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Identifiable assets:	
Swimwear sales	\$ 1,780,870
	-----
Film productions	1,436,659
Corporate	1,201,925
	-----
 Total assets	 \$ 4,419,454
	=====

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SHOPNET.COM, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

NOTE - 12            SEGMENT INFORMATION (continued)

Operating profit is total revenue less cost of sales and operating expenses and excludes general corporate expenses, interest expenses and income taxes. Identifiable assets are those used by each segment of the Company's operations. Corporate assets are primarily cash and investments.

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ITEM 2.            MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

CAUTIONARY STATEMENTS ON FORWARD-LOOKING STATEMENTS

Statements contained in this report which are not historical facts and may be considered forward looking information with respect to plans, projections, or future performance of the Company as defined under the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties which could cause actual results to differ materially from those projected. The words "anticipate ", "believe", "estimate", "expect", "objective", and "think" or similar expressions used herein are intended to identify forward-looking statements. The forward-looking statements are based on the Company's current views and assumptions and involve risks and uncertainties that include, among other things, the effects of the Company's business, actions of competitors, changes in laws and regulations, including accounting standards, employee relations, customer demand, prices of purchased raw material and parts, domestic economic conditions, including housing starts and changes in consumer disposable income, and foreign economic conditions, including currency rate fluctuations. Some or all of the facts are beyond the Company's control.

General

Shopnet.com, Inc. ("Shopnet" or the "Company") was incorporated in the State of Delaware on December 1, 1995 as Hollywood Productions, Inc. On May 10, 1999, Shopnet filed an amendment to its Articles of Incorporation effecting a change in its name to its current one. On May 12, 1999, it incorporated a new wholly-owned subsidiary, Hollywood, to which it assigned its motion picture business thereby rendering Shopnet a holding company for Hollywood and another wholly-owned subsidiary, Breaking Waves. Shopnet was

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formed initially for the purpose of acquiring screenplays and producing motion pictures. In September 1996, in connection with the completion of its IPO, it acquired all of the capital stock of Breaking Waves which designs, manufactures, and distributes private and brand name label children's swimwear. As of June 30, 2002, the company changed its year end from December 31 to June 30.

The consolidated financial statements at March 31, 2003 and 2002 included the accounts of Shopnet and its wholly owned subsidiaries, Breaking Waves and Hollywood (collectively referred to as the "Company") except where otherwise indicated after elimination of all significant intercompany transactions and accounts.

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related footnotes which provide additional information concerning the Company's financial activities and condition. Since Shopnet and its subsidiaries operate in different industries, the discussion and analysis is presented by entity in order to be more meaningful.

### Critical Accounting Policies

#### a) Principles of consolidation

The accompanying consolidated financial statements include the accounts of Shopnet and its wholly owned subsidiaries, Breaking Waves and Hollywood (the "Company"), after elimination of all significant intercompany transactions and accounts. Affiliated companies which are 20 to 50 percent owned are accounted for under the equity method.

#### b) Inventory

Inventory consists of finished goods and is valued at the lower of cost (using the first-in, first-out method) or market. All inventory is pledged as collateral for factored receivables pursuant to a factoring agreement with a financial institution

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

### Critical Accounting Policies (continued)

#### c) Film production and distribution costs

The Company follows industry standards in capitalizing film production and distribution costs. Film production and distribution costs include all costs associated with the writing, producing, and distribution of the film. Film costs include the costs of production, prints, pre-release, and other advertising expected to benefit future periods. These costs, as well as participation and talent residuals, are charged against earnings on an individual film basis in the ratio that the current year's gross film revenues bear to management's estimate of total remaining ultimate gross film revenues from all sources.

Film costs are stated at the lower of cost or estimated net realizable value on an individual film basis. Revenue and cost forecasts are continually reviewed by management and revised when warranted by changing conditions. Estimates of total gross revenue

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can change significantly due to the level of amortization, as adjusted. Such adjustments could have a material effect on the results of operations in future periods. When estimates of total revenue and costs indicate that a feature film will result in an ultimate loss, additional amortization is recognized to the extent required to produce a zero gross margin over the remaining life of the film.

### d) Equity Method of Accounting

Investments in significantly (20 to 50 percent) owned affiliates are accounted for by the equity method of accounting, whereby the investment is carried at cost of acquisition, plus the Company's equity percentage in undistributed earnings or losses since acquisition. Reserves are provided where management determines that the investment or equity in earnings is not realizable.

### e) Income taxes

The Company accounts for income taxes in accordance with the "liability method" of accounting for income taxes. Accordingly, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Current income taxes are based on the respective periods' taxable income for federal, state and city income tax reporting purposes.

### f) Revenue and cost recognition

The terms of Breaking Waves' sales are FOB shipping point thereby revenue is recognized upon shipment from the warehouse. Sales returns are recorded upon acceptance of the goods by the warehouse. Duty costs, which are a component of cost of sales, are recorded upon the clearance of such goods through customs.

Revenues from the theatrical distribution of motion pictures are recognized when motion pictures are exhibited. Revenues from video sales are recognized, together with related costs, on the date that video units are made widely available for sale by retailers. Revenues from the licensing of feature films, together with related costs, are recorded when the material is available for telecasting by the licensee and when certain other conditions are met. Film production and distribution costs are stated at the lower of unamortized cost or estimated net realizable value. In accordance with Financial Accounting Standards Board's Statement of Financial Accounting Standards ("SFAS") No. 53, "Financial Reporting by Producers and Distributors of Motion Pictures Films," the individual film forecast method is used to amortize film costs.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Critical Accounting Policies (continued)

### g) Earnings per share

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Earnings per common share is computed pursuant to SFAS No. 128 "Earnings Per Share." Basic earnings per share is computed as net income (loss) available to common share holders divided by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur from common shares issuable through stock options, warrants and convertible preferred stock.

### h) Use of estimates

In preparing financial statements in conformity with generally accepted accounting principles generally accepted in the United States of America, management is required to make estimates and assumption which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. The most significant estimate with regard to these financial statements is the estimate of projected income of motion pictures which is the basis used in amortizing film production and distribution costs. Actual results could differ from those estimates.

### i) Fair value disclosure at March 31, 2003 and June 30, 2002:

The carrying value of cash, accounts receivable, inventory, accounts payable, accrued expenses, and capital lease obligations are a reasonable estimate of their fair value.

Three months ended March 31, 2003 as compared to the three months ended March 31, 2002

For the three months ended March 31, 2003, the Company reported consolidated net income of \$304,924 as compared to a consolidated income of \$535,131 for the three months ended March 31, 2002.

### Breaking Waves

For the three months ended March 31, 2003 and 2002, Breaking Waves generated net sales of \$5,098,551 and \$4,612,362, respectively, with related cost of sales amounting to \$3,441,519 and \$2,828,915 respectively. The increase in sales amounting to \$486,189, or approximately 11%, from 2002 to 2003 was primarily attributable an increase in orders from the Company's customers.

The gross profit for the three months ended March 31, 2003 amounted to \$1,657,032, or 33% of sales as compared to the three months ended March 31, 2002 during which it amounted to \$1,783,447, or 39% of sales.

Selling, general, and administrative expenses during the three months ended March 31, 2003 and 2002 amounted to \$990,342 and \$946,295, respectively. The increase amounting to \$44,047 or approximately 5%, is primarily attributable to an increase in selling expenses as a result of increased sales efforts.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Breaking Waves (continued)

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The major components of the Breaking Waves selling, general, and administrative expenses are as follows for the three months ended March 31:

Officers, office staff, designer and sales , salaries and related benefits

Commission expense

Warehousing costs

Royalty fees

Rent expense

Factor commissions

Miscellaneous general corporate overhead expenses

Interest expense in connection with the factoring agreement amounted to \$80,325 and \$88,075 for the three months ended March 31, 2003 and 2002, respectively. The decrease is due primarily to a decrease in interest rates.

Breaking Waves generated net income of \$403,395 and \$635,014 for the three months ended March 31, 2003 and 2002 respectively.

### Hollywood

On May 12, 1999, Shopnet incorporated a wholly-owned subsidiary, Hollywood, to which it assigned its film production business. All film related operations prior to May 12, 1999 were conducted by Shopnet under its former name.

For the three months ended March 31, 2003 and 2002, Hollywood generated no sales from its motion picture "Dirty Laundry". Although sales prior to and including the nine months ended June 30, 2002 were minimal, the company expects to effect increased sales during the fiscal year ending June 30, 2002 and thereafter as a result of the implementation of a new marketing strategy which among other things, emphasizes the development of new marketing and distribution arrangements for "Dirty Laundry". Upon a review of the net realizable value of the movie cost, management has determined that no write down was necessary as of March 31, 2003 and 2002, respectively. Accordingly, Hollywood generated a loss of \$14,728 and \$600 for the three months ended March 31, 2003 and 2002, respectively. The loss of \$14,728 includes an equity loss of \$13,928 from Hollywood's investment in The Girl, LLC, a joint venture.

Subsequent to "Dirty Laundry", Hollywood also has invested in other movie ventures, some of which have generated revenue to date. See "Investment in Joint Ventures."

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

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Shopnet.com

For the three months ended March 31, 2003 and 2002, Shopnet generated no income.

Shopnet's selling, general, and administrative expense amounted to \$82,742 and \$99,283 for the three months ended March 31, 2003 and 2002. This represents a decrease of \$15,241, or approximately 16%.

The major components of the Company's expenses are as follows for the three months ended March 31:

Salaries (officer and office staff) and stock compensation  
and related benefits  
Rent  
Legal and professional fees  
Consulting fees  
Other general corporate and administrative expense

200  
-----  
\$

Shopnet generated a net loss of \$83,742 and \$99,283 for the three months ended March 31, 2003 and 2002, respectively.

Nine months ended March 31, 2003 as compared to the nine months ended March 31, 2002

For the nine months ended March 31, 2003 and 2002, the Company reported a consolidated net loss of \$262,632 and \$13,408 after an income tax expense of \$0 respectively, and a comprehensive net loss of \$262,632 and \$19,632, respectively.

Breaking Waves

For the nine months ended March 31, 2003 and 2002, Breaking Waves generated net sales of \$5,849,229 and \$6,313,067, respectively, with related cost of sales amounting to \$3,688,757 and \$3,927,537, respectively. The decrease in sales amounting to \$463,838, or approximately 8%, from 2002 to 2003 was primarily attributable to the subsequent deferment of new orders into the next period.

The gross profit for the nine months ended March 31, 2003 amounted to \$2,160,472, or 37% of sales as compared to the nine months ended March 31, 2002 during which it amounted to \$2,385,530, or 38% of sales. The decrease in the gross profit percentage can be attributable to a deferment of orders into the next period.

Selling, general, and administrative expenses during the nine months ended March 31, 2003 and March 31, 2002 amounted to \$1,837,832 and \$1,735,638, respectively. The increase amounted to \$102,194 or 4%.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Breaking Waves (continued)



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The major components of the Breaking Waves selling, general, and administrative expenses are as follows for the nine months ended March 31:

Officers, office staff, designer and sales , salaries and related benefits

Commission expense  
Warehousing costs  
Royalty fees  
Rent expense  
Factor commissions

Miscellaneous general corporate overhead expenses

Interest expense in connection with its factoring agreement amounted to \$144,027 and \$190,908 for the nine months ended March 31, 2003 and 2002, respectively. The decrease is due to a decrease in sales, as well as a reduction in the stated prime interest rate.

Breaking Waves generated a net loss of \$29,906 for the nine months ended March 31, 2003 and net income of \$296,607 for the nine months ended March 31, 2002.

Hollywood

For the nine months ended March 31, 2003 and 2002, Hollywood generated no sales from its motion picture "Dirty Laundry". Although sales prior to and including the six months ended June 30, 2002 were minimal, the company expects to effect increased sales during the fiscal year ending June 30, 2002 and thereafter as a result of the implementation of a new marketing strategy which among other things, emphasizes the development of new marketing and distribution arrangements for "Dirty Laundry". Upon a review of the net realizable value of the movie cost, management has determined that no write down was necessary as of March 31, 2003 and 2002, respectively. Accordingly, Hollywood generated a loss of \$15,928 and \$663 for the nine months ended March 31, 2003 and 2002, respectively. The loss of \$15,928 includes an equity loss of \$13,928 from Hollywood's investments in The Girl, LLC, a joint venture.

Subsequent to "Dirty Laundry", Hollywood also has invested in other movie ventures, some of which have generated revenue to date. See "Investment in Joint Ventures."

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Shopnet.com

For the nine months ended March 31, 2003 and 2002, Shopnet generated no

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income.

Shopnet's selling, general, and administrative expense amounted to \$215,799 and \$309,352 for the nine months ended March 31, 2003 and 2002. This represents a decrease of \$93,553, or approximately 31%.

The major components of the Company's expenses are as follows for the nine months ended March 31:

	2003
	-----
Salaries (officer and office staff) and stock compensation and related benefits	\$ 98,9
Rent	-
Legal and professional fees	34,7
Consulting fees	43,3
Other general corporate and administrative expense	38,7

Shopnet generated a net loss of \$216,799 and \$309,352 for the nine months ended March 31, 2003 and 2002, respectively. The net loss for the nine months ended March 31, 2002 included, on a consolidated basis, amortization of goodwill of \$53,214.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Liquidity and Capital Resources

At March 31, 2003, the Company's consolidated working capital deficit amounted to \$548,006.

At March 31, 2003, current assets consisted primarily of inventory of \$1,549,900 and prepaid expenses of \$238,961.

On or about September 12, 2000, Breaking Waves entered into a factoring and revolving inventory loan and security agreement ("factoring agreement") with Century Business Credit Corporation ("Century") to sell its interest in all present and future receivables without recourse. Breaking Waves submits all sales offers to Century for credit approval prior to shipment, and pays a factoring commission of .75% of receivables sold.

Century retains from the amount payable to Breaking Waves a reserve for possible obligations such as customer disputes and possible credit losses on unapproved receivables. Breaking Waves may take advances of up to 85% of eligible receivables and up to 50% of the value of finished goods in inventory, with interest payable monthly at the rate of 1 3/4% over prime.

Pursuant to the terms of a Reimbursement and Compensation Agreement, a trust ("Trust"), the beneficiary of which is a relative of the Company's President and Chief Executive Officer ("CEO") and a relative of a principal stockholder, pledged assets as collateral for securing a \$250,000 letter of credit to replace a portion of a letter of credit previously pledged by the Company.

Accordingly, on December 20, 2000 the original agreement with the factor was amended to allow such replacement of collateral. Breaking Waves'

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Loan and Security Agreement with Century dated December 20, 2000 requires the provision of one or more letters of credit in the aggregate amount of \$1,150,000 to partially secure the line of credit. On September 15, 2001, Century required the Company to increase the amount of collateralized standby letters of credit by \$300,000 raising such amount to \$1,450,000.

On May 3, 2001, the Agreement with the Trust was amended so that the letter of credit secured by the Trust was increased to \$400,000. As a condition of the amendment, the Company entered into a guarantee agreement with Gal Capital Corp., whose President is a relative of the Company's President and CEO and a principal stockholder of the Company to act as guarantor of the obligation to the Trust up to \$400,000 in exchange for a fee of \$42,500 which the Company paid on May 3, 2001. The amended letter of credit expired on September 1, 2001 and was subsequently amended on September 15, 2001.

On September 15, 2001, the Amended and Restated Reimbursement and Compensation Agreement was entered into and further amended the agreement with the Trust, so that the letter of credit secured by the Trust was increased to \$750,000. The amended letter of credit expired on September 1, 2002 but can be extended year to year at the Company's option for a period of ten years. On September 1, 2002, the letter of credit was extended. Breaking Waves agreed to reimburse the Trust for any and all losses, fees, charges and expenses to the Trust in the event the letter of credit is called by Century and/or the issuing bank demands reimbursement from the Trust. Breaking Waves' obligations are guaranteed by the Company in addition to being secured by a first security interest in all of the assets of the Company and a subordinate security interest in all of the assets of Breaking Waves.

In December 2002, Breaking Waves entered into a Reimbursement and Compensation Agreement with TERE, S.A., a Swiss entity. As a consequence of Century being unwilling to grant credit to Breaking Waves unless it received one or more letters of credit satisfactory to it as well as cash collateral to partially secure the line of credit in such amounts as it deems appropriate, the Trust reduced the letter of Credit secured by it to \$500,000. TERE, S.A. agreed to loan Breaking Waves the sum of \$250,000 represented by a promissory note.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

#### Liquidity and Capital Resources

The funds were deposited as cash collateral with Century to replace the reduced portion of the letter of credit secured by the Trust.

All obligations under this agreement are guaranteed by the Company and are secured by a security interest in all of the Company's assets.

As compensation, Breaking Waves paid all interest received from or credited to it by Century on the sums deposited pursuant to the Cash Collateral Agreement when received.

The term of the loan is for ten years.

ARC has agreed to pay to TERE, interest at the rate of 8% per annum on quarterly basis.

On September 15, 2001, the Company entered into a Reimbursement Agreement with relatives of a principal stockholder who is related to the President

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and CEO of the Company ("RAYA") who pledged assets as collateral for securing a \$300,000 letter of credit as additional collateral to secure Breaking Waves' Loan and Security Agreement with Century. Absent any default, the letter of credit will remain in effect for ten years. The Agreement is guaranteed by Shopnet under a separate Security Agreement dated September 15, 2001.

In exchange for the letters of credit, the Trust and RAYA will proportionately, based on the total outstanding letters of credit, receive a fee of one and one quarter percent (1-1/4%) of net sales of Breaking Waves through June 30, 2002 and thereafter one and three quarters percent (1-3/4%) of net sales through September 30, 2011. In October 2001, the Trust and RAYA received advance payments to be applied towards future fees of \$24,500 and \$12,250, respectively. All future payments are payable forty five days after the close of each fiscal quarter. The fees are effective October 1, 2001.

In September 2001, the Company and Breaking Waves retained Arc Financial Corp. ("ARC"), a British Virgin Island company, for a ten year term to provide financial consulting services.

Pursuant to the terms of a consulting services. Pursuant to the terms of a consulting agreement ("ARC Consulting Agreement"), ARC was retained to assist the Company in the acquisition of financing to acquire inventory and for other corporate purposes ("Financing"), as well as consult with the Company with regard to its ongoing operations, promote sales of Breaking Waves' products and improving production.

Pursuant to the terms of the ARC Consulting Agreement, the Company and Breaking Waves agreed to compensate ARC (i) an annual fee of \$20,000 ("Base Fee") and (ii) a percentage of annual net sales in the amount of 1-1/4% through June 30, 2002 and 1-3/4% of net sales for each year of the term thereafter through September 30, 2011 ("ARC Percentage Fee"), payable 45 days after the closing of each fiscal quarter.

In October 2001, ARC received (I) a lump sum payment of \$209,000 reflecting full advance payment of the Base Fee and (ii) \$36,750 reflecting advance payment of the Arc Percentage Fee. The agreement with Arc expires September 30, 2011. The Company and Breaking Waves are entitled to terminate the ARC Consulting Agreement any time after September 30, 2006, in which event all prepaid fees are forfeited.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

#### Liquidity and Capital Resources

The following table summarizes the percentage due each party, as noted above, as a percentage of net sales for the three months ended March 31, 2003:

	% of Net Sales	Amount
	-----	-----
RAYA	0.58	\$ 29,572
ZAT	1.16	59,143
ARC	1.75	89,225
	-----	-----

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3.49

\$ 177,940

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Interest expense related to the factor agreement totaled \$144,027 and \$190,908 for the nine months ended March 31, 2003 and 2002, respectively. Century has a secured interest in Breaking Waves' inventory as collateral for the advances. As of March 31, 2003, the net advances to Breaking Waves from Century amounted to \$1,364,327.

On November 8, 2002, the Company borrowed the sum of \$50,000 in the form of a promissory note from Amigal Salit, Ltd., and unrelated party. The note which is non-interest bearing is due on or before August 15, 2003.

On the same date, the Company entered into an agreement with ARC Financial Corporation, whereby the Company using the proceeds received from Amigal Salit, Ltd., agreed to pay \$50,000 as an advance against fees to be owned by Breaking Waves to ARC Financial Corporation in connection with Breaking Waves obligation to pay certain fees to ARC as part of a consulting agreement as described in Note 7 (b) herein. The consulting fees being paid in advance under this agreement are those fees which would become due and payable for the periods ending March 31, 2003 and March 31, 2003.

## Investments in Joint Ventures

### Battle Studies Productions, LLC

In April 1998, the Company entered into a co-production agreement with North Fork Bank for "Machiavelli Rises." The Company and North Fork formed Battle Studies to finance, produce and distribute the film. Battle Studies will be treated as a joint venture in order to co-produce motion pictures and to finance the cost of production and distribution of such motion pictures. The joint venture retains all rights to the motion pictures, the screenplays, and all ancillary rights attached thereto. Total production costs to date have aggregated approximately \$425,000 of which the Company has funded approximately \$218,500. In accordance with the terms of the co-production agreement, the proceeds of the film will be distributed as follows: first, both parties shall be entitled to recoup their initial investment in the film, at 135% thereof; then, after repayment to the respective parties of additional cost incurred by same, any remaining proceeds shall be distributed 50% to North Fork and 50% to the Company. The film was shown in January 1999 in both New York and the Brussels Film Festival.

The Company accounts for the investment in Battle Studies on the equity method. For the nine months ended March 31, 2003 and 2002, the Company, recorded no equity losses for its proportionate share of Battle Studies. No revenues have been derived from this film as of March 31, 2003.

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

On October 12, 2001, Battle Studies entered into a distribution agreement with Raven Pictures International ("Raven Pictures") to distribute Battle Studies' motion picture ("Macheavelli Rises") to foreign countries. Battle Studies has granted rights under the agreement for the theatrical, video, non-theatrical and television markets. The term of the agreement is for twenty-four months for all portions of territory outside of the United States and English speaking Canada. Battle Studies expects to realize 75% (which is net of a 25% fee to Raven Pictures) of the expected estimated gross

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revenues derived from foreign countries less \$20,000 for marketing and advertising expense.

On January 17, 2002, Battle Studies entered into a distribution agreement with KOAN to distribute and promote Battle Studies' motion picture ("Machiavelli Rises") in the United States and Canada. Battle Studies has granted rights under the agreement for free TV, pay TV, cable, satellite, video and DVD markets. The terms of the agreement is for twenty-four months and it will be automatically renewed unless KOAN receives a letter of cancellation at least thirty days prior to the date of termination or if sales have not exceeded \$250,000 over the twenty-four month period. Battle studies expects to realize 70% (which is net of a 30% fee to KOAN) of the expected estimated gross revenues derived from the United States and Canada less \$5,000 per year for promotional costs.

The Girl, LLC

Pursuant to an agreement dated July 1, 1999 with ALF for the production of a film entitled "The Girl", Hollywood invested through March 31, 2003, \$35,000 for a 22.533% interest in a new entity, The Girl, LLC a limited liability company ("Girl LLC"). In return for its participation in Girl LLC, Hollywood shall be entitled to receive a non-contested, non-dilutable 22.533% ownership interest in Girl LLC, a recoupment of its investment on no less favorable terms than any other investor and 22.533% of 100% of any contingent compensation which shall be actually received by Girl LLC. Girl LLC retains all rights to the motion pictures, the screenplays, and all ancillary rights attached thereto. "The Girl" is completed and has been exhibited at several film festivals. Girl LLC is in the process of attempting to secure video and foreign distribution arrangements for the film.

Hollywood accounts for the investment in Girl LLC under the equity method. Accordingly, as of March 31, 2003, the Company has recorded its investment at \$21,072. This represents its initial investment of \$35,000 less \$13,928 of equity loss for its proportionate share of Girl LLC.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

#### Lease Commitments

Shopnet and Breaking Waves jointly share their administrative offices under a lease agreement signed July 2001 by Breaking Waves. Shopnet is provided office space by Breaking Waves on a rent-free basis. The lease agreement expires on September 30, 2007. Annual rent under this lease is \$84,915 through December 31, 2004 and \$97,560 for the remainder of the lease period. Additionally, Breaking Waves leases an offsite office for one of its designers on a month to month basis with annual payments approximating \$13,200.

The approximate annual future minimum rentals under non-cancelable operating lease signed by Breaking Waves are as follows:

For the fiscal year ended June 30:

2003

\$

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2004  
2005  
2006  
2007  
Thereafter

-----  
\$  
=====

Rent expense for the nine months ended March 31, 2003 and 2002 amounted to \$81,646 and \$94,508, respectively.

License Agreement

During June 2000, Breaking Waves entered into a license agreement with an effective date of November 1, 2000 with Gottex Models Ltd., as Israeli corporation and Gottex Models (USA) Corp., a New York corporation for the use of the trademark "Gottex" in the United States of America for children's swimwear. The agreement calls for a royalty fee of 7% of net sales with guaranteed minimum annual royalties of \$70,000 to \$140,000 over the life of the agreement. Breaking Waves recorded royalties under the agreement totaling \$113,019 and \$68,430 for the nine months ended March 31, 2003 and March 31, 2002, respectively.

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ITEM 3. CONTROLS AND PROCEDURES

As of March 31, 2003, an evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, The Company's management including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure, our disclosure controls and procedures were effective as of March 31, 2003, there have been no significant changes in the Company's internal controls or in other factors that could significantly affect our internal controls subsequent to March 31, 2003.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

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None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

a) Exhibit

99.1 Certification by Harold Rashbaum, Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

b) Reports

None

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SHOPNET.COM, INC.

By:/s/ Harold Rashbaum  
Harold Rashbaum, President, Chief Executive Officer  
and Chief Financial Officer

Dated: May 16, 2003



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CERTIFICATION

I, Harold Rashbaum, certify that:

1. I have reviewed this quarterly report of Form 10-Q of Shopnet.com, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiary, is made know to me by other within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure

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controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

- c) Presented in this quarterly report my conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
- 5. I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function);
  - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
- 6. I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 16, 2003

/s/Harold Rashbaum  
Harold Rashbaum  
President