SHOPNET COM INC
Form 10QSB
May 20, 2002

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

FORM 10-QSB
(Mark One)

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

For the quarterly period ended March 31, 2002,

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 Incorporation or Organization)	(IRS Employer Identification No.)

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 [X] 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: 7,472,224 shares outstanding as of May 20, 2002.

SHOPNET.COM, INC. AND SUBSIDIARIES

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SHOPNET.COM, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
As of March 31, 2002 and June 30, 2001

ASSETS

	(U
Current assets:	
Cash	
Cash-restricted	
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	
Deferred tax asset-non-current	
Other assets	
Marketable securities-affiliate	
Total assets	

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:
Due to factor
Accounts payable
Accrued expenses
Current portion of lease
Other taxes payable
Deferred tax liability

Total current liabilities

Capital lease obligations, net of current portion

Total liabilities

Commitments and contingencies

Stockholders' equity
Common stock- $.001 par value, 20,000,000 shares authorized, 7,472,244 shares issued and outstanding
Additional paid in capital
Accumulated deficit
Accumulated other comprehensive income

Total stockholders' equity

Total liabilities and stockholders' equity

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

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

	Nine Months Ended March 31, 2002	March 31, 2001	Three M March 31, 2002
Net sales	$ 6,313,067	$ 5,692,623	$ 4,612,362
Cost of sales	3,927,537	3,709,898	2,828,915
Gross profit	2,385,530	1,982,725	1,783,447
Expenses:			
Selling, general, and administrative	2,007,246	1,967,230	1,028,099

Amortization of costs in excess of net assets of business acquired	53,214	53,214	17,738
Total expenses	2,060,460	2,020,444	1,045,837
Income (loss) before other income (expenses) and provision for income taxes	325,070	(37,719)	737,610
Other income (expenses):			
Equity in earnings (loss) of affiliate	(595)	(4,837)	(532)
Write down of film costs	--	(208,564)	--
Rental income	9,050	18,106	--
Interest and financial expense	(357,941)	(339,171)	(202,022)
Interest income	11,008	59,478	75
Total other income (expense)	(338,478)	(474,988)	(202,479)
Income (loss) before provision for income taxes	(13,408)	(512,707)	535,131
Provision (benefit) for income taxes	--	(16,974)	--
Net income (loss)	(13,408)	(495,733)	535,131
Other items of comprehensive income (loss)	(6,350)	(254,000)	--
Comprehensive (loss)	$ (19,758)	$ (749,733)	$ 535,131
Basic:			
Net income loss per share	$ (Nil)	$ (.07)	$ .07
Weighted average number of common shares outstanding	7,472,244	7,472,244	7,472,244

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

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

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit

Balances at June 30, 2001 (Audited)	7,472,244	$ 7,472	$ 6,638,852	$(4,017,179)
Net loss (Unaudited)				(13,408)
Comprehensive loss	--	--	--	--
Balances at March 31, 2002, ...	$ 7,472,244	$ 7,472	$ 6,638,852	$(4,030,587)

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, 2002 And 2001
(Unaudited)

	March 31 2002
Cash flows from operating activities:	
Net loss	$ (13,408
Adjustments to reconcile net income to net cash used in operating activities:	
Equity in loss of affiliate	595
Amortization and depreciation	73,857
Decrease (increase) in:	
Accounts receivable	(19,884
Other receivables	62,734
Inventory	(577,528
Prepaid expenses	(187,906
Advances to officer	(1,971
Other assets	(4,700
Investment in securities available for sale	--
Marketable securities affiliate	6,350
Increase (decrease) in:	
Due to factor	(835,407
Accounts payable	547,905
Accrued expenses	(834
Other taxes payable	104
Net cash used in operating activities	(950,093
Cash flows from investing activities:	
Acquisition of property and equipment	(28,636
Net cash used in investing activities	(28,636
Cash flows from financing activities:	
Principal payments on capital leases	(14,098
Reduction in line of credit	--

Net cash used in financing activities	(14,098
Net decrease in cash and restricted cash	(992,827
Cash and restricted cash, beginning of period	994,285
Cash and restricted cash, end of period	$ 1,458
Supplemental disclosure of cash flow information: cash paid during the period for :	
Interest	$ 282,737
Income taxes	$ --

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

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, 2001, 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, 2002 and for the nine month periods ended March 31, 2002 and March 31, 2001 and for the three month periods ended March 31, 2002 and March 31, 2001 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, 2002 and the results of operations and cash flows for the nine month periods ended March 31, 2002 and March 31, 2001 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, 2001 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, 2001 and for the six month period then ended and notes thereto included in the Company's report on Form 10-KSB filed on October 15, 2001.

The Company in the quarter ended March 31, 2002 has implemented a number of initiatives which it believes will reduce its costs of operations and alleviate in the following three months its working capital deficiency. In particular, the Company believes that the repayment of its indebtedness to Century (See Note 7 (b)) and the recent reductions in interest rates will reduce interest expense.

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, 2002. 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-002 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 statements.

During June 2001, SFAS No. 141, "Business Combinations" ("SFAS No. 141") was released. This standard addresses financial accounting and reporting for business combinations. All business combinations within the scope of SFAS 141 are to be accounted for using one method-the purchase method. The provisions of SFAS 141 apply to all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method for those business combinations is prohibited. It also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001 or later.

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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 this transaction, excess of cost over net assets acquired totaling $1,064,283 was recorded and is being amortized over the useful lives of the related assets which is fifteen years. Amortization expense totaled $53,214 for each of the nine months ended March 31, 2002 and 2001.

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, 2002, $218,165 for a 50% interest in a new entity, Battle Studies Productions, LLC ("Battle Studies") a limited liability company. Battle Studies will be treated as a joint 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, 2002 $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, 2002 and 2001, the Company recorded $595 and $0, respectively, in net equity losses.

NOTE 6- MARKETABLE SECURITIES- AFFILIATE

Breaking Waves owns 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 is also the President of Shopnet and Breaking Waves.

Breaking Waves' ownership percentage is approximately 1.5% of Play Co. The investment in Play Co. is accounted for under the requirements of SFAS No. 115, "Accounting for Certain investments in Debt and Equity Securities." Under SFAS No. 115, the securities are considered available for sale and therefore the carrying value is based on the fair market value of the securities at March 31, 2002 and 2001 which amounted to $0 and $337,000, respectively.

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SHOPNET.COM, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

NOTE 6- MARKETABLE SECURITIES- AFFILIATE (continued)

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 are therefore considered non-current (See Note 6 (b)).

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

NOTE 7- DUE TO FACTOR

a) CIT Group

On August 20, 1997, Breaking Waves entered into a factoring and revolving Inventory loan and security agreement (as amended December 9,1998) with CIT Group (formerly, Heller Financial, Inc. "CIT") to sell their interest in all present and future receivables without recourse. Breaking Waves paid CIT a factoring commission of .85% of the first $5,000,000 of receivables sold and .65% of receivables sold in excess of $5,000,000 for each year.

Breaking Waves took advances of up to 85% of the receivables, with interest at the rate of 1 3/4% over prime. In connection with the factoring agreement, the Company agreed to maintain $1,150,000 of cash in a segregated account in order to collateralize standby letters of credit. In addition, during 1999, Breaking Waves was required to transfer an additional $200,000 of cash as collateral for the standby letter of credit.

On or about September 12, 2000 the agreement with CIT was cancelled and a new factoring agreement was entered into as discussed below.

b) 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.

NOTE 7- DUE TO FACTOR

b) Century Business Credit Corporation (continued)

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.

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 expires on September 1, 2002 but can be extended year to year at the Company's option for a period of ten years. 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.

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.

NOTES TO FINANCIAL STATEMENTS

NOTE 7- DUE TO FACTOR

b) 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.

Interest expense related to the factor agreement totaled $190,908 and $256,510 for the nine months ended March 31, 2002 and 2001, respectively. Century has a secured interest in Breaking Waves' inventory as collateral for the advances. As of March 31, 2002, the net advances to Breaking Waves from Century amounted to $864,930.

During October 2001, Century released the Company from its requirement of maintaining a minimum cash balance as a result of the events discussed in Note 7 (b). Upon Century removing the restriction, the Company paid and reduced the amount due to Century in October and November 2001 by an aggregate of $620,000.

SHOPNET.COM, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

NOTE 8- OTHER EVENTS

On January 23, 2002, the Company notified the Nasdaq Stock Market, Inc. ("Nasdaq") of the withdrawal of its listing from the SmallCap Market, effective with that date.

The Company previously received notification from Nasdaq in late November 2001, advising that it did not satisfy the minimum net tangible assets or equity standards for continued listing on the Nasdaq SmallCap Market.

The Company explored its options in this regard, and determined that its resources would best be allocated in areas that could improve its results of operations. The Company's common stock and warrants had traded on the Nasdaq SmallCap Market since September 1996.

Following the delisting from Nasdaq, the Company's securities began trading on the OTC Bulletin Board.

NOTE 9- COMMITMENTS AND CONTINGENCIES

a) Lease commitments

Shopnet and Breaking Waves have entered into lease agreements for their administrative offices. Shopnet leased its administrative office pursuant to a 5-year lease that expired on November 30, 2001 at annual rent amounting to approximately $70,000, before annual escalations. Breaking Waves terminated its lease effective November 30, 2001. A new 6 year lease expiring September 30, 2007 was signed in July 2001, becoming effective beginning December 1, 2001.Annual rent under the new lease is $84,915 through December 31, 2004 and $95,760 for the remainder of the lease. Lastly, Breaking Waves leases an offsite office for one of its designers on a month to month basis with annual payments approximating $11,000. The Company and Breaking Waves' approximate future minimum rentals under non-cancelable operating leases in effect on March 31, 2002 are as follows:

2002	$ 85,480
2003	84,915
2004	84,915
2005	90,338
2006	95,760
Thereafter	119,700
	$561,108

Rent expense for the nine months ended March 31, 2002 and 2001 amounted to $94,508 and $128,130, respectively.

SHOPNET.COM, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

NOTE 9- COMMITMENTS AND CONTINGENCIES (continued)

b) Significant vendors and customers

Breaking Waves purchases 100% of its inventory from two vendors, one in Indonesia and the other in South Korea. Breaking Waves believes other sources and vendors are available and that it is not dependent exclusively on these vendors.

c) Seasonality

Breaking Waves' business is considered seasonal with a large portion of its revenues and profits being derived between November and March. 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

i) On October 16, 1995, Breaking Waves entered into a license agreement with Beach Patrol, Inc. ("Beach") for the exclusive use of certain trademarks in the United States. The agreement covered a term from January 1, 1996 to June 30, 1998 and contained a provision for an additional three-year extension, at the option of Breaking Waves, through and until June 30, 2001. Breaking Waves had exercised this option, thereby so extending the agreement. The agreement called for minimum annual royalties of $75,000 to $200,000 over the life of the agreement with options based on sales levels from $1,000,000 for the first year to $4,000,000 in the sixth year. Breaking Waves has negotiated an additional two-year extension thereby extending the agreement through and until June 30, 2003, and it contains a provision for an additional two-year extension, at the option of Breaking Waves, through and until June 30, 2005. The new agreement signed February 28, 2001 and effectively July 1, 2001 calls for minimum annual royalties of $50,000 to $87,500 over the life of the extension with option based on sales levels from $1,000,000 for the seventh year to $1,750,000 in the tenth year. Breaking Waves recorded royalties under this agreement totaling $30,000 and $138,897 during the nine months ended March 31, 2002 and 2001 respectively.

ii) 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 $68,430 and $23,746 for the nine months ended March 31, 2002 and 2001, respectively.

NOTE 9- COMMITMENTS AND CONTINGENCIES (continued)

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 the marketing and distribution process.

As of March 31, 2002, 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, 2002 and 2001, the Company derived no revenue from the motion picture and amortized no film costs.

For the nine months ended March 31, 2002 and 2001 the Company has written down its film production and distribution costs by $0 and $50,000, respectively, in order to reduce the asset to 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). 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 complaint was recently amended. The defendants including the Company have made a motion to dismiss the complaint. There can be no assurance that this motion will be granted. The Company intends to contest the action vigorously and believes that such claims against it are baseless and without merit.

In or about December 2001, a group of over 275 foreign plaintiffs commenced an action entitled Abeln v. Arbel, et. al in the United States District Court for the Southern District of New York naming the Company, along with over 30 other entities and individuals as defendants. The Company has not yet been served with the summons and complaint, and cannot discern if such service will be effectuated. Thus, the Company is not yet a party to the suit.

The Complaint purports to state claims, among others, for securities fraud, RICO, breach of contract, common law fraud and breach of fiduciary duty allegedly arising out of the defendants' supposed involvement with the preferred stock of Europe American Capital Corporation ("EACC"). The complaint is unclear but it appears that only the RICO and common law fraud claim are alleged as against the Company.

NOTE 9- COMMITMENTS AND CONTINGENCIES (continued)

f) Litigation (continued)

Among other things, the plaintiffs claim that a large amount of EACC's funds have been invested in the Company. The plaintiffs allege that they incurred losses and damages in excess of $25,000,000. The action seeks an unstated amount of monetary damages together with punitive damages.

This matter has been delayed by the court because of an apparent dispute regarding who will represent the plaintiffs.

Should the Company be served, it anticipates seeking Court approval to make a motion to dismiss the complaint for among other reasons, failure to state a claim.

In light of the early stage of this action, the Company's counsel is unable to form an opinion as to the likelihood of an unfavorable outcome.

NOTE 10- STOCKHOLDERS' EQUITY

a) Earnings per share

Earnings per common share is computed pursuant to Statement of Financial Accounting Standards (SFAS) No. 128 "Earnings Per Share" ("EPS"). Basic earnings per share is computed as net income (loss) available to common shareholders divided by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock options, warrants and other convertible securities. Diluted EPS is not presented since the effect would be anti-dilutive.

b) 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, 2001. On August 31, 2001, 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 100% common stock dividend, the January 2000 10% common stock dividend and the May 2000 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.

SHOPNET.COM, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

NOTE 10- STOCKHOLDERS' EQUITY (continued)

b) Warrants (continued)

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.

NOTE - 11 RELATED PARTIES TRANSACTIONS

a) For the nine months ended March 31, 2002 and 2001 financial consulting fees were paid to a corporation and an individual who are related to the Company's President and CEO amounting to $36,320 and $34,000, 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, 2002, the unpaid portion amounted to $37,000, which has been classified as current. As of March 31, 2002, 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.

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 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. Information about the two segments is as follows:

		Nine Months
	2002	
	Segment	Consolidated
Sales:		
Swimwear sales	$ 6,313,067	
Film production	-	
Total sales		$ 6,313,067
Operating income (loss):		
Swimwear sales		$ 649,892
Film production		(600)
Total operating income (loss)		$ 649,292
Corporate:		
General and administrative expense		$ (271,008)
(Loss) equity in earnings of affiliate		(595)
Amortization expense		(53,214)
Interest income		11,008

Interest and finance expense	(357,941)
Other	9,050
Loss from operating before (benefit)	(13,408)
Provision for income tax	-
Net (loss) income	$ (13,408)
Identifiable assets:	
Swimwear sales	$ 1,604,943
Film productions	1,451,104
Corporate	1,143,940
Total assets	$ 4,199,987

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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.

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 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, 2001, the company changed its year end from December 31 to June 30.

The consolidated financial statements at March 31, 2002 and 2001 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 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

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, 2002 and June 30, 2001:

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, 2002 as compared to the three months ended

March 31, 2001

For the three months ended March 31, 2002, the Company reported a consolidated net income of $535,131 as compared to a consolidated net income of $207,797 for the three months ended March 31, 2001. Comprehensive income for the three months ended March 31, 2002 was $535,131 as compared to comprehensive income of $112,547 for the three months ended March 31, 2001.

Breaking Waves

For the three months ended March 31, 2002 and 2001, Breaking Waves generated net sales of $4,612,362 and $3,653,260, respectively, with related cost of sales amounting to $2,828,915 and $2,437,428 respectively. The increase in sales amounting to $959,102, or approximately 26%, from 2002 to 2001 was primarily attributable to the greater acceptance of the Company's product line and increased marketing efforts.

The gross profit for the three months ended March 31, 2002 amounted to $1,783,447, or 39% of sales as compared to the three months ended March 31, 2001 during which it amounted to $1,215,832 or 33% of sales.

Selling, general, and administrative expenses during the three months ended March 31, 2002 and 2001 amounted to $ 946,295 and $ 711,879, respectively. The increase amounting to $234,416 or approximately 33%, is primarily attributable to an increase in selling and warehousing expenses which reflect the increase in sales volume.

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

Breaking Waves (continued)

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

	2002	2001
Officers, office staff, designer and sales , salaries and related benefits	$157,810	$134,459
Commission expense	195,912	128,325
Warehousing costs	270,087	190,462
Royalty fees	45,819	89,887
Rent expense	26,381	24,522
Factor commissions	49,222	36,276
Miscellaneous general corporate overhead expenses	201,064	107,948

Interest expense in connection with its factoring agreement amounted to $88,075 and $156,022 for the three months ended March 31, 2002 and 2001, respectively. The decrease is due to a reduction in the stated prime interest rate.

Breaking Waves generated net income of $635,014 and $351,767 for the three months ended March 31, 2002 and 2001 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, 2002 and 2001, Hollywood generated no sales from its motion picture "Dirty Laundry". Although sales prior to and including the nine months ended June 30, 2001 were minimal, the Company is expending efforts 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". Hollywood generated a loss of $600 and $947 for the three months ended March 31, 2002 and 2001, respectively.

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."

Shopnet.com

For the three months ended March 31, 2002, Shopnet generated no income. For the corresponding three months ended March 31, 2001, Shopnet generated income amounting to $21,615 comprised of interest from its money market and sublet income from its corporate office.

Shopnet's selling, general, and administrative expense amounted to $99,283 and $143,023 for the three months ended March 31, 2002 and 2001. This represents a decrease of $43,740, or approximately 31%.

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

Shopnet.com (continued)

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

	2002	2001
Salaries (officer and office staff) and stock compensation and related benefits	$ 28,741	$44,684
Rent	0	19,156
Legal and professional fees	17,234	18,650
Consulting fees	10,400	6,000
Other general corporate and administrative expense	42,908	54,533

Shopnet generated a net loss of $99,283 and $143,023 for the three months ended March 31, 2002 and 2001, respectively. These net losses include, on a consolidated basis, amortization of goodwill of $17,738 in each period.

Nine months ended March 31, 2002 as compared to the nine months ended March 31, 2001

For the nine months ended March 31, 2002 and 2001, the Company reported a consolidated net loss of $13,408 and $495,733. Comprehensive loss for the nine months ended March 31, 2002 was $19,758 as compared to a comprehensive loss of $749,733 for the nine months ended March 31, 2001.

Breaking Waves

For the nine months ended March 31, 2002 and 2001, Breaking Waves generated net sales of $6,313,067 and $5,692,623, respectively, with related cost of sales amounting to $3,927,537 and $3,709,898, respectively. The increase in sales amounting to $620,444, or approximately 11%, from 2002 to 2001 was primarily attributable to the greater acceptance of the Company's product line and increased marketing efforts.

The gross profit for the nine months ended March 31, 2002 amounted to $2,385,530, or 38% of sales as compared to the nine months ended March 31, 2001 during which it amounted to $1,982,725 or 35% of sales.

Selling, general, and administrative expenses during the nine months ended March 31, 2002 and 2001 amounted to $1,735,638 and $1,537,272, respectively. The increase amounting to $198,366 or approximately 13%, is primarily attributable to an increase in selling and warehousing expenses which reflect the increase in sales volume.

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

	2002	2001
Officers, office staff, designer and sales , salaries and related benefits	$433,239	$416,535
Commission expense	189,093	168,607
Warehousing costs	355,751	268,175
Royalty fees	98,430	162,643
Rent expense	74,998	71,303
Factor commissions	62,687	52,965
Miscellaneous general corporate overhead expenses	521,440	397,044

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

Breaking Waves (continued)

Interest expense in connection with its factoring agreement amounted to $190,908 and $293,216 for the nine months ended March 31, 2002 and 2001, respectively. The decrease is due to a reduction in the stated prime interest rate.

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

Breaking Waves' ownership percentage is approximately 1.5% of Play Co.'s outstanding Common Stock. The investment in Play Co. is accounted for under the requirements of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities. " Under SFAS 115, the securities are considered available for sale and therefore the carrying value is based on the fair market value of the securities at March 31, 2002 and 2001 which amounted to $0 and $12,700, respectively. The change in the fair market value of the securities during the periods is recorded as an unrealized gain or loss as a component of comprehensive income. The company has pledged such shares as collateral for a standby letter of credit in connection with Breaking Waves' factoring agreement with Century Business Credit Corporation ("Century") and the are therefore considered non-current.

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

Breaking Waves recorded an unrealized (loss) gain of $(6,350) and $(254,000) for the nine months ended March 31, 2002, and 2001 respectively, which has been recorded as a component of comprehensive income (loss) in the statement of operations.

Breaking Waves generated net income of $296,607 for the nine months ended March 31, 2002 and net income of $172,184 for the nine months ended March 31, 2001.

Hollywood

For the nine months ended March 31, 2002 and 2001, Hollywood generated no sales form its motion picture "Dirty Laundry". Although sales prior to and including the nine months ended June 30, 2001 were minimal, the Company is expending efforts 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 a $0 and $208,564 write down was necessary as of March 31, 2002 and 2001, respectively, Accordingly, Hollywood generated a loss of $663 and $214,064 for the nine months ended March 31, 2002 and 2001, respectively.

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, 2002 and 2001, Shopnet generated minimal income comprised of interest from its money market and sublet income from its corporate office.

Shopnet's selling, general, and administrative expense amounted to $309,352 and $453,853 for the nine months ended March 31, 2002 and 2001. This represents a decrease of $144,501 or approximately 32%.

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

2002

Salaries (officer and office staff) and stock compensation and related benefits	$99,3
Rent	19,5
Legal and professional fees	72,3
Consulting fees	22,3
Other general corporate and administrative expense	95,7

Shopnet generated a net loss of $309,352 and $453,853 for the nine months ended March 31, 2002 and 2001, respectively. These net losses include, on a consolidated basis, amortization of goodwill of $17,738 in each period.

Liquidity and Capital Resources

At March 31, 2002, the Company's consolidated working capital amounted to $189,503.

At March 31, 2002, current assets consisted primarily of inventory of $1,374,066.

In September 2000, Breaking Waves entered into a factoring and revolving inventory loan and security agreement with 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 the receivables, with interest at the rate of 1 3/4% over prime. In connection with the factoring agreement, the Company agreed to maintain $1,150,000 of cash in segregated account in order to collateralize standby letters of credit for Breaking Waves. Additionally, Breaking Waves was required to pledge as additional collateral, $200,000 of its own cash and the Play Co. shares. Additional collateral of $400,000 came from a third party which is a trust ("Trust"), the beneficiary of which is the granddaughter of the Company's President and Chief Executive Officer and the daughter of a principal stockholder of the Company.

In September 2001, Century increased the required collateral in the amount of $300,000, from $1,150,000. Subsequent to March 31, 2002, the Company effected financing arrangements with two parties (one of which is the Trust, the other relatives of as principal stockholder of the Company) providing for assets in the aggregate amount of $1,050,000 ("Financing"), representing a portion of the $1,450,000 required collateral. The provision of the assets in connection with the financing arrangements provided for the $300,000 increase in required collateral and replacement of the Company's certificates of deposit in the amount of $350,000.

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

Liquidity and Capital Resources (continued)

The assets provided by such parties are available to Breaking Waves for a ten year term, subject to earlier termination in the event of default. Breaking Waves is obligated to make an annual payment to each of the two entities which provided such assets, equal to an aggregate of 1-1/4% of net sales of Breaking Waves through June 30, 2002, and an aggregate of 1-3/4% of net sales of Breaking Waves for each year the letter of credit is available thereafter, payable 45 days after the end of each fiscal quarter. In October 2001, such entities received funds in the aggregate amount of $36,750 reflecting advance payment of such amounts.

At March 31, 2002, the Company was indebted to Century in the aggregate amount of approximately $865,000.

Interest expense related to the Century factoring agreement totaled $190,908 and $256,510 for the nine months ended March 31, 2002 and 2001, respectively. Century has a continuing interest in Breaking Waves' inventory as collateral for the advances.

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 agreement ("ARC Consulting Agreement"), ARC was retained to assist the Company in the acquisition of financing to acquire inventory and for other corporate purposes, as well as consult with the Company with regard to its ongoing operations, including systems to control expenses, method to enhance and promote sales of Breaking Waves' products and improving production. ARC assisted the Company in the Financing. 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 ("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 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 Company anticipates that its current available cash will be sufficient for the next twelve months and does not anticipate any cash shortfalls. In the March 31, 2002 quarter, the Company implemented a number of initiatives which it believes will reduce its cost of operations and overhead. In particular, the Company believes that the repayment of its indebtedness to Century in the amount of approximately $1,982,879 will translate into decreased interest expense projected to be approximately $50,000 for the next fiscal quarter.

In December 2001, the Company consolidated all of its operations in the New York metropolitan region into new facilities where Breaking Waves currently operates, resulting in annualized rental savings estimated at approximately $60,000 over the next 12 months, plus additional savings in utilities and other office and personnel expenses resulting from the economies generated by the consolidated operations. The Company expects that these savings as well as salary reductions that the Company implemented during the March 31, 2002 quarter, will amount to approximately $130,000 during the current fiscal year ending June 30, 2002.

The Company has recently refocused its sales efforts, to the extent possible, to eliminate unprofitable or low margin sales. This is compounded with improved sales and orders during the quarter ended March 31, 2002. Breaking Waves did ship sales orders during the month of April 2002 of approximately $1,100,000. There can be no assurance that such figures will be indicative of future results, that the Company will be successful in collecting all receivables, or that any orders booked as of April 2002 will not ultimately be cancelled.

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, 2002 and 2001, the Company, recorded $595and $0, respectively, of equity losses for its proportionate share of Battle Studies. No revenues have been derived from this film as of March 31, 2002.

On October 12, 2000, 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 revenues derived from foreign countries less $20,000 for marketing and advertising expense.

On January 17, 2001, 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.

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

Investments in Joint Ventures (continued)

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, 2002, $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, 2002, the Company has recorded its investment at $33,702. This represents its initial investment of $35,000 less $1,298 of equity loss for its proportionate share of Girl LLC.

Factoring Arrangements

CIT Group

On August 20, 1997, Breaking Waves entered into a factoring and revolving inventory loan and security agreement (as amended December 9, 1998) with CIT Group (formerly, Heller Financial, Inc. "CIT") to sell their interest in all present and future receivables without recourse. Breaking Waves paid CIT a factoring commission of .85% of the receivable, with interest at the rate of 1 3/4% over prime. In connection with the factoring agreement, the Company agreed to maintain $1,150,000 of cash in a segregated account in order to collateralize standby letters of credit. In addition, during 1999, the Company was required to transfer an additional $200,000 of cash as collateral for the standby letter of credit. On or about September 12, 2000 the agreement with CIT was cancelled and a new factoring agreement was entered into with Century. Interest expense related to this agreement totaled $0 and $36,706 for the nine months ended March 31, 2002 and 2001, respectively.

Lease Commitments

Shopnet leased its administrative office pursuant to a 5-year lease that expired on November 30, 2001 at annual rent amounting to approximately $70,000, before annual escalations. Upon the lease expiration, Shopnet relocated to Breaking Waves's facilities. Breaking Waves terminated its lease effective November 30, 2001. A new 6-year lease expiring September 30, 2007 was signed by Breaking Waves in July 2001 and is effective beginning December 1, 2001. Annual rent under the new lease is $84,915 through December 31, 2004 and $95,760 for the remainder of the lease. Breaking Waves also maintains a Florida office, comprising approximately 780 square feet, with annual payments of approximately $11,000.

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

License Agreements

On October 16, 1995, Breaking Waves entered into a license agreement with Beach Patrol, Inc. Pursuant to the licensing agreement, Breaking Waves was given the right to use certain designs for its children's line under the "Daffy Waterwear" label from January 1, 1996 to June 30, 1998. Thereafter, the agreement provided for a three year extension, at the option of Breaking Waves, through and until June 30, 2001. Breaking Waves has exercised this option, thereby extending the agreement. The agreement calls for minimum annual royalties of $75,000 to $200,000 over the life of the agreement with options based on sales levels from $1,000,000 for the first year to $4,000,000 in the sixth year. Breaking Waves has negotiated an additional two year extension thereby extending the agreement through June 30, 2003, and it contains a provision for an additional two year extension, at the option of Breaking Waves, through and until June 30, 2005. The new agreement signed February 28, 2001 and effective July 1, 2001 calls for minimum annual royalties of $50,000 to $87,500 over the life of the extension with option based on sales levels from $1,000,000 for the seventh year to $1,750,000 in the tenth year. Breaking Waves recorded royalties and advertising under this agreement totaling $30,000 and $138,897 during the nine months ended March 31, 2002, and 2001, respectively.

During June 2000, Breaking Waves entered into a license agreement with an effective date of November 1, 2000 with Gottex Models Ltd., and 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, subject to certain exceptions. The license agreement also requires the Company to expend certain minimum amounts on advertising each year. The license agreement is for a term of three years, subject to earlier termination in accordance with its terms. In the nine months ending March 31, 2002, Breaking Waves recorded $68,430 in royalty expenses related to the minimum guaranteed royalties contained in its agreement with Gottex. In the corresponding nine months ended March 31, 2001, Breaking Waves recorded royalties of $23,746.

PART II

Item 1. Legal Proceedings

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). 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 complaint was recently amended. The defendants including the Company have made a motion to dismiss the complaint. There can be no assurance that this motion will be granted. The Company intends to contest the action vigorously and believes that such claims against it are baseless and without merit.

In or about December 2001, a group of over 275 foreign plaintiffs commenced an action entitled Abeln v. Arbel, et. al in the United States District Court for the Southern District of New York naming the Company, along with over 30 other entities and individuals as defendants. The Company has not yet been served with the summons and complaint, and cannot discern if such service will be effectuated. Thus, the Company is not yet a party to the suit.

Among other things, the plaintiffs claim that a large amount of EACC's funds have been invested in the Company. The plaintiffs allege that they incurred losses and damages in excess of $25,000,000. The action seeks an unstated amount of monetary damages together with punitive damages.

This matter has been delayed by the court because of an apparent dispute regarding who will represent the plaintiffs.

Should the Company be served, it anticipates seeking Court approval to make a motion to dismiss the complaint for among other reasons, failure to state a claim.

In light of the early stage of this action, the Company's counsel is unable to form an opinion as to the likelihood of an unfavorable outcome.

The Complaint purports to state claims, among others, for securities fraud, RICO, breach of contract, common law fraud and breach of fiduciary duty allegedly arising out of the defendants' supposed involvement with the preferred stock of Europe American Capital Corporation ("EACC"). The complaint is unclear but it appears that only the RICO and common law fraud claim are alleged as against the Company.

The Company is not a party to any other material litigation and is not aware of any threatened litigation that would have a material adverse effect on its business. Neither the Company's officers, directors, affiliates, nor owners of record or beneficially of more than five percent of any class of the Company's Common Stock is a party to any material proceeding adverse to the Company or has a material interest in any such proceeding adverse to the Company.

PART II

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: None

Item 5. Other Information: None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits: None

(b) Reports on Form 8-K: None

SIGNATURES

In accordance with the requirements of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 20th day of May 2002.

SHOPNET.COM, INC.

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