SHOPNET COM INC
Form 10KSB
October 15, 2001

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

FORM 10-KSB

(Mark One)

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

For the fiscal year ended December 31, 2000

OR

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

For the transition period from January 1, 2001 to June 30, 2001

Commission File Number O-28690

SHOPNET.COM, INC.
(Name of Small Business Issuer in Its Charter)

Delaware	13-3871821
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

14 East 60th Street, Suite 402, New York, New York 10022
(Address of Principal Executive Offices)

(212) 688-9223
(Issuer's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of Each Class and Name of Each Exchange on Which Registered
NONE

Securities registered pursuant to Section 12(g) of the Exchange Act:
Common Stock, $.001 par value
(Title of Class)

Check whether the Issuer (1) has 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 [ ]

Check if no disclosure of delinquent filers in response to Item 405 of Regulation S-B is contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB [ ].

The Registrant's consolidated revenues for its six month transition period ended June 30, 2001 were $4,728,948.

The aggregate market value of the voting stock on October 10, 2001 (consisting of Common Stock, par value $0.001 per share) held by non-affiliates was approximately $1,964,201 based upon the closing price for such Common Stock on said date ($.42), as reported by a market maker. On such date, there were 7,472,224 of Registrant's Common Stock outstanding.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

The statements which are not historical facts contained in this Transition Report are forward looking statements that involve risks and uncertainties, including, but not limited to instability of revenues, future losses and unpredictable operating results. The Company's actual results may differ materially from the results discussed in any forward looking statement. Unless otherwise indicated, all references to the number of our shares of common stock give effect to the 1 for 3 reverse stock split effected in February 1998, 100% Common Stock dividend effected in February 1999, 10% Common Stock dividend effected in February 2000 and the 20% Common Stock dividend effected in June 2000.

In June 2001, the Company's Board of Directors voted to change the end of the Company's fiscal year from December 31 to June 30. The accompanying consolidated financial statements as of June 30, 2001 reflect the results of operations for the six months ended June 30, 2001.

History

ShopNet.com, Inc. (the "Company" or "Shopnet") was formed in December 1995 in the State of Delaware, as Hollywood Productions, Inc. ("HPI"). Its purpose was to acquire screenplays and produce motion pictures. The Company changed its name from "Hollywood Productions, Inc." to "Shopnet.Com, Inc." in May 1999.

In September 1996, the Company acquired Breaking Waves, Inc. ("Breaking Waves"), a New York corporation which remains a wholly owned subsidiary of the Company. This acquisition was contingent upon and was consummated simultaneously with the Company's initial public offering ("IPO") and marked the Company's entrance into the business of designing, manufacturing, and distributing (throughout the United States) young girls' swimwear and coordinating beach cover-ups and accessories.

In May 1999, Shopnet incorporated a new subsidiary, Hollywood Productions, Inc. ("Hollywood"), to which Shopnet assigned its motion picture business. As a result, Shopnet is now a holding company, owning 100% of Hollywood and Breaking Waves. Except where otherwise indicated, Shopnet and its subsidiaries are collectively referred to herein as the "Company."

Motion Picture Business

General

Since its inception in December 1995, the Company has co-produced three motion pictures: "Dirty Laundry," "Machiavelli Rises" and "The Girl." Each such film had limited theatrical runs shortly after release. The Company's primary focus for the forseeable future will be to work directly, or through distribution arrangements with third parties, to establish distribution for these completed films through public or cable television - via pay-per-view, premium and standard channels - the sale of video rights and/or foreign distribution. To a lesser extent, the Company will continue to seek to acquire screenplays and produce motion pictures, either directly or through collaborative arrangements, to be distributed primarily through public or cable television and the sale of video rights.

"Dirty Laundry"

In March 1995, the Company entered into a property acquisition agreement (the "Purchase Agreement") and a co-production agreement (the "Production Agreement") with Rogue Features, Inc. ("Rogue"), an unaffiliated entity, to acquire the rights to and co-produce a motion picture of the screenplay entitled "Dirty Laundry." In addition, the Company and Rogue entered into a right of first refusal agreement with respect to the next two products of Rogue and/or its principals.

In April 1996, the Company formed D.L. Productions, Inc. ("D.L. Productions"), a New York corporation, as a wholly owned subsidiary, for the purpose of holding title to and producing the Dirty Laundry film and receiving revenues from the distribution thereof. The Purchase Agreement conveyed all rights to the screenplay and the film itself to the Company. In return, Rogue directed "Dirty Laundry" and has the right to 25% of its profits as described in the Production Agreement. Rogue also retained the right to produce a live comedy or musical upon the earlier of five years after Dirty Laundry's release or the Company's approval. In addition, Michael Normand, a principal of Rogue, retained the right to adapt the screenplay of Dirty Laundry into a novel on the Company's approval of the compensation it is to receive therefrom. The Production Agreement provided for the principals of Rogue to direct and retain creative control of the production of the film while the Company retains final approval.

In November 1997, with production of the movie complete, the Company effected the dissolution of D.L. Productions. Its assets were transferred to the Company, and the Company took over the marketing of Dirty Laundry.

In June 1998, the Company entered into an agreement with Artistic License Films, Inc. ("ALF") whereupon ALF agreed to use its best efforts to distribute the film in at least three New York theaters and two Los Angeles theaters. In exchange for its efforts, ALF received a $20,000 retainer fee which constitutes an advance against ALF's distributor's fee of 25% of the gross receipts from the theatrical distribution of the film

The film was released to five New York and three Los Angeles theaters. It had a limited run during the fall of 1998 and received marginal reviews (two stars out of four). Currently, the Company is directly working to distribute the film through various channels, including public or cable television, the sale of video rights and foreign distribution.

"Dirty Laundry" is a romantic comedy shot in the New York tri-state area. It stars Jay Thomas as Joey (a dry cleaner going through a mid-life crisis), and Tess Harper as Beth (a sex advice columnist for a woman's magazine and Joey's wife of 15 years). Joey's dry cleaning business is doing poorly, and he is convinced that he is aging prematurely. Given their increasing lack of intimacy, Beth encourages Joey to seek counseling, which he does unbeknownst to Beth, who has become attracted to her chiropractor. Throughout the film, a variety of bizarre mishaps occur which result in the couple's rekindling of their lost romance with a surprise ending. Mr. Thomas has co-starred in the motion picture "Mr. Holland's Opus" and is known for his television work in "Love & War," "Cheers," "Murphy Brown," and "Mork & Mindy," and, until recently, was the host of WTJM "Jammin" 105.1 FM, a New York radio station. Ms. Harper earned a Golden Globe nomination for her performance in the film "Tender Mercies" and an Oscar nomination for her role in the film "Crimes of the Heart."

"Machiavelli Rises"

In April 1998, the Company entered into a co-production agreement with North Folk Films, Inc. ("North Folk") for the production of a film entitled "Machiavelli Rises." The Company and North Folk formed a limited liability company, Battle Studies Productions, LLC ("Battle Studies"), to finance, produce, and distribute the film which commenced production in April 1998. The film was completed in November 1998. The film was written, directed, and co-produced by Efraim Horowitz and can be characterized as a contemporary ghost story about power, greed, love, and Leonardo Da Vinci's lost notebook. Total production costs to date have aggregated approximately $433,000, of which the Company has funded approximately $217,500. 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 costs incurred by same, any remaining proceeds shall be distributed 50% to North Folk and 50% to the Company. The film was shown in January 1999 in both New York and at the Brussels Film Festival.

In February 2000, "Machiavelli Rises" was one of thirty-eight films showcased at the New York Independent Film Festival ("NYIFF") in New York City where it was honored with the award for Best Screenplay. In addition, it was chosen (along with only six other films) for presentment at the Los Angeles distribution of the NYIFF in April, 2000.

In September 2000 and January 2001, Battle Studies entered into two-year agreements with each of Raven Pictures International and Koan, Inc. for the distribution of "Machiavelli Rises" internationally and domestically, respectively. See "Management's Discussion and Analysis or Plan of Operation - Investment in Joint Ventures - Battle Studies Productions, LLC." To date, the film has not generated any distribution revenues.

"The Girl"

In July 1999, the Company entered into an agreement with ALF with respect to the production of a film entitled "The Girl." Pursuant to such agreement, the Company and ALF formed a limited liability company, The Girl, LLC ("Girl LLC"), to finance, produce and distribute the film. As of June 30, 2001, the Company invested $35,000 for a 22.533% interest in Girl LLC. "The Girl" was completed in the spring of 2001, has been exhibited at several film festivals and had a very limited theatrical distribution in New York City. The Girl LLC is in the process of attempting to secure video and foreign distribution arrangements.

"The Girl," which was filmed in Paris, categorized as a faux film noir, chronicles a lesbian relationship.

Production

The Company intends to continue to review screenplays for acquisition and co-production, although to a lesser extent. Typically, once a screenplay is acquired (i) a budget is prepared, (ii) revisions to the screenplay are made, (iii) the talent, production crews, and all ancillary items required for the filming of the motion picture are hired and/or otherwise obtained, and (iv) a film schedule is established. Once filming is complete, the film is edited, sound and special effects are added, and a final print is produced. The Company then arranges private showings of the film and attempts to secure domestic and foreign distributors.

Production of a motion picture requires approximately five to eight weeks of filming followed by approximately fourteen weeks of editing and adding sound and special effects. An additional twelve to sixteen weeks generally is required in order to secure a distributor for the film. If the Company cannot find a distributor, it will attempt to distribute the film itself. Once this process is complete, the film will be ready for release to theaters or other distribution channels. See "--Distribution, Billing and Revenues."

Distribution, Billing and Revenues

Generally, distribution of a film may be undertaken either by a motion picture studio, an independent distributor, or through an agent. The Company expects that any existing films or future films it may produce will be distributed by an independent distributor or itself through an agent. In a distribution arrangement, the production company and the distributor determine who will incur what portion of the costs of marketing a film, at which time a budget is prepared and the extent of the release of the film is determined. The release of films may be done in platforming stages. A screening is then held, and critics are invited to review the film. If the film receives a favorable response from either the critics and/or the audience, the film's distribution will expand gradually into additional markets and theaters.

The Company does not expect extensive theatrical distribution of its existing or future films. Rather, after limited theatrical distribution a film may be distributed through public or cable television - via pay-per-view, premium, and standard channels - and/or through the sale or rental of videotapes. The Company may enter into agreements with different distributors for different markets or sell all the rights to one distributor. Revenues generated are distributed to all parties involved including the distributor, the producers, the owners, and the talent pursuant to extensive formulas previously agreed upon.

Distribution rights to motion pictures are granted legal protection under the copyright laws of the United States and most foreign countries which provide substantial civil and criminal sanctions for unauthorized duplication and exhibition of motion pictures. The Company plans to take all appropriate and reasonable measures to secure, protect, and maintain or obtain agreements from licensees to secure, protect, and maintain copyright protection for all of the motion pictures it distributes under the laws of all applicable jurisdictions.

The Company estimates that between 12 and 18 months will elapse between the commencement of expenditures by the Company in the acquisition of a screenplay, the production of a motion picture, and its release. The Company does not expect to receive revenues, if any, from the exploitation of a film until approximately 24 to 36 weeks after its release. Notwithstanding there can be no assurance that any completed film will ever establish distribution at any level or generate any revenues to the Company. Billing in the industry typically occurs quarterly: theaters pay distributors on a quarterly basis, and the Company is paid the following quarter. In the event a distributor desires to distribute one of the Company's films, however, such distributor may either (i) offer an initial payment to the Company against, or in addition to, future royalties or (ii) purchase the film outright.

Regulations

The Code and Ratings Administration of the Motion Picture Association of America, an industry trade association, assigns ratings for age-group suitability for viewing of motion pictures. While the Company will follow the practice of submitting most of its motion pictures for such ratings, the Company may review this policy from time to time.

United States television stations and networks, as well as foreign governments, impose regulations on the content of motion pictures which may restrict, in whole or in part, exhibition on television or in a particular territory. There can be no assurance that current and future restrictions on motion pictures released by the Company will not limit or affect the Company's ability to exhibit such motion pictures.

Competition in the Film Industry

The film industry is immense with many well capitalized industry leaders producing commercial films capable of wide theatrical distribution. The Company competes, and will continue to compete, with these and other institutions which produce, distribute, exploit and finance films, many of which have substantial financial and human resources considerably more extensive than the Company's. These institutions include the major film studios - including Disney, Universal, MGM, and Sony - as well as smaller independent film companies and television and cable networks. Industry members compete substantially for the hire or purchase of a limited number of producers, directors, actors, and screenplays which are able to attract major distribution in all media and all markets throughout the world.

The motion picture business is highly competitive and has an extremely high profile in terms of name recognition, with relatively insignificant barriers to entry, and numerous entities compete for the same directors, producers, actors/actresses, distributors, theaters, etc. There is intense competition within the film industry for exhibition times at theaters, as well as for distribution in other media, and for the attention of the movie-going public and other viewing audiences. Competition for distribution in other media is as intense as the competition for theatrical distribution, and not all films are licensed in other media. Each year, numerous production companies are formed, and numerous motion pictures are produced, all of which motion pictures seek full distribution and exploitation. Despite the increase in the number of films, a small number of films, those which receive widespread consumer acceptance, account for a large percentage of total box office receipts.

Swimwear Business

General

Breaking Waves is a designer, manufacturer, and distributor of girl's swimwear which is sold throughout the United States. In addition to swimwear, Breaking Waves also manufactures beach cover-ups and accessories to coordinate with its swimwear. Swimwear is made in children's sizes from 2-16 and in pre-teen sizes.

Breaking Waves markets swimwear under private brand labels including "Breaking Waves," "All Waves," and "Making Waves." In July 2000, Breaking Waves added a new line of girls' swimwear which is sold under the label, "Coral Cove." Breaking Waves also licenses rights to the name "Daffy Waterwear" and the "Gottex" trademark in connection with the manufacture and sale of girls' swim and related beach wear.

Products, Design, Supplies and Inventory

Breaking Waves designs, manufactures, and sells both private label and name brand girl's swimwear and accessories. It has an office in Homestead, Florida where its designer designs all styles for its swimwear lines and accessory items. Each season, roughly 20-25 prints and fabrics are developed for the "Breaking Waves" line, with generally between 10 to 20 prints and fabrics developed for each of its other lines. For the six months ended June 30, 2001, the "Coral Cove" line accounted for approximately one-third of Breaking Waves' total sales volume, with the other four lines accounting for, in equal parts, the remainder of Breaking Waves' volume for such period. Prior to the introduction of the "Coral Cove" and "Gottex" lines, for the year ended December 31, 2000, the "All Waves" line accounted for approximately one-third of Breaking Waves' total volume, with the remaining two lines accounting for, in equal parts, the remainder of Breaking Waves' volume.

In designing its children's swimwear, Breaking Waves adapts certain of the prints and styles it is provided by Beach Patrol Inc., the licensor of "Daffy Waterwear" and Gottex Models Ltd. which management feels are appropriate for children's wear. Of each fabric or print chosen, the Company usually manufactures two swimsuits: a one-piece model and a two-piece model.

Once Breaking Waves has chosen the prints and colors it desires to use for its children's swimwear, it sends the artwork for the fabric to its agent in Korea who disseminates them to one or more clothing manufacturers for prototyping and the knitting or weaving and printing of fabrics. The manufacturer returns the fabrics to Breaking Waves, and upon Breaking Waves' approval, the fabrics are sent, with the desired design, to any one or more of several Indonesian or Korean companies where the fabric is cut and sewn into a completed product. Finished goods are shipped from the manufacturer to a public warehouse in the City of Industry, California. Breaking Waves has found that this process is the most cost-effective means of operating its business. It expects to continue its operations in this manner in the future, though it may use other manufacturers and suppliers in different countries.

Breaking Waves' swimwear typically is produced in two blended fabrics: one is a blend of nylon and lycra spandex, and the other is a blend of cotton, polyester, and lycra spandex. Each product line uses different designs and emphasizes different fabric blends.

For the six months ended June 30, 2001, 80% of Breaking Waves' finished products were purchased from an Indonesian manufacture, with the balance purchased from a Korean manufacturer. For the year ended December 31, 2000 Breaking Waves' finished products were purchased 80%, 15% and 5% from Indonesian, Samoan and Korean manufacturers, respectively. Although the Company believes that the fabrics and non-fabric sub-materials it uses are readily available and that there are numerous manufacturers for such piece goods who offer similar terms and prices, there can be no assurance that management is correct in such belief. The unavailability of fabrics or the absence of clothiers, or the availability of either at unreasonable cost, could adversely affect the operations of Breaking Waves and the Company.

Since Breaking Waves purchases finished garments from overseas contractors, it does not buy or maintain an inventory of sub-materials. It has not experienced difficulty in satisfying finished garment requirements and considers its sources of supply adequate. Breaking Waves' inventory of garments varies depending upon its backlog of purchase orders and its financial position.

Marketing and Sales

The "Breaking Waves," "Daffy Waterwear," "Coral Cove" and "Gottex" lines are distributed and sold through better department and specialty stores. The "All Waves" label is sold to mass merchants and also as promotional goods in department stores. Private label programs are supplied to several major chains and department store groups.

Breaking Waves sells its swimwear and accessory items through its showroom sales staff and through independent sales representatives. Over the past several years, certain of its customers have included the Dillard and Federated department store groups as well as Kids R Us, Sears, Wal-Mart, T.J. Maxx and Marshalls. For the six months ended June 30, 2001, Breaking Waves had two customers representing in the aggregate, 37% of net sales, as compared to three customers representing in the aggregate, 46% of net sales, for the year ended December 31, 2000.

Breaking Waves' merchandise is shipped pursuant to purchase orders sent by its customers and is sent f.o.b. shipping point (freight on board) meaning Breaking Waves is neither responsible for the goods during shipment nor for the delivery charge. Payment is due 30 days after shipment. No goods are shipped on consignment; therefore, except for non-conforming or damaged goods, all goods shipped are considered sold.

In addition to its in-house sales and showroom personnel, approximately twenty independent sales representatives throughout the United States sell Breaking Waves merchandise on a non-exclusive basis. These representatives service department stores and smaller specialty retailers. In some cases, separate independent representatives sell the "Daffy Waterwear" line. None of these representatives is under contract with Breaking Waves; nor does any receive a salary. Rather, each is paid a commission based upon his sales. In addition to showroom sales and sales representatives calling on customers, Breaking Waves exhibits its products at major trade shows. End of season and discontinued merchandise is sold to off-price stores.

Suspended Internet Activities

In March 1999, Breaking Waves launched an online wholesale children's swimwear website at www.breakingwaves.com. The website was designed to complement the company's wholesale distribution efforts by providing retailers instant access to more than 200 styles of Breaking Waves swimwear. The Company has determined, however, not to pursue this method of distribution, and its website is now dormant.

Work in Progress

Breaking Waves manufactures its swimwear lines from June to December based on its knowledge of the market and past sales. Customer orders generally start arriving in June and July. Goods are reordered by customers on a continual basis through the following June. The quantity of open purchase orders at any date may be affected by, among other things, the timing and recording of orders. Breaking Waves does not sell on consignment and accepts return of only such products as are imperfect or shipped in error.

The major design work takes place from January to May. Goods are manufactured, printed, and sewn overseas from June to December. Finished garments are shipped from the factory to a public warehouse in Los Angeles for shipments to retailers. The majority of shipments to retailers are made from November to May, with January through March being the peak shipping time.

Trademarks

Breaking Waves relies on common law and registered trademarks for usage of its private label swimwear lines under the names "Breaking Waves," "All Waves" and "Coral Cove." Breaking Waves has licensed rights to the "Daffy Waterwear" and "Gottex" names for girls swim and beach wear. See "Management's Discussion and Analysis or Plan of Operations of - License Agreements" for a description of each of such license arrangements.

There can be no assurance that such trademarks owned or licensed by the Company adequately will be protected against infringement. In addition, there can be no assurance that Breaking Waves will not be found to be infringing on another company's trademark. In the event Breaking Waves finds another party to be infringing upon one of its trademarks, if registered, or is found by another company to be infringing upon such company's trademark, there can be no assurance that Breaking Waves will be successful in any resultant litigation it may ultimately become involved in.

Competition

There is intense competition in the swimwear apparel industry. Breaking Waves competes with many other manufacturers in these markets, many of which are larger and have greater resources than it does. Major competitors in the swimwear industry include "Ocean Pacific," "Ralph Lauren," and "Speedo." In addition, department stores and retailers have their own private label programs which are the major competition in the mass merchant business.

Breaking Waves' business is highly competitive with relatively insignificant barriers to entry and with numerous firms competing for the same customers. Breaking Waves is in direct competition with local, regional, and national clothing manufacturers, many of which have greater resources and more extensive distribution and marketing capabilities than it does. In addition, many large retailers have recently commenced sales of "store brand" garments which compete with those sold by Breaking Waves. Management believes that Breaking Waves' market share is not significant in its product lines.

Many of the national clothing manufacturers have extensive advertising campaigns which develop and reinforce brand recognition. In addition, many of such manufacturers have agreements with department stores and national retail clothing chains to jointly advertise and market their products. Since Breaking Waves does limited advertising and marketing and has no agreement with any department store or national retail chain to advertise any of its products, it competes with companies that have brand names that are well known to the public. All other factors being equal, it can be expected that a retail shopper will buy a "brand name" garment before he buys an "unknown" brand, depending on price.

Seasonality

Breaking Waves' business is seasonal. A large portion of its revenues and profits are derived between November and March. Each year from April through October, Breaking Waves designs and manufactures the following season's swimwear lines. There can be no assurance that revenues received from December to June will support Breaking Waves' operations for the rest of the year.

Employees

Mr. Harold Rashbaum, the Company's Chairman of the Board, President and Chief Executive Officer oversees the Company's consolidated operations. The Company has one other executive officer, a designer, controller and 3 office personnel to oversee Breaking Wave's operations on a full-time basis, and employs a Vice-President of Design, Merchandising and Production on a part-time basis. Breaking Waves has approximately twenty independent sales persons representing the Breaking Wave's lines on a non-exclusive basis. Hollywood's operations are governed by Mr. Rashbaum. Most screenwriters, performers, directors, and technical personnel involved in the Company's films are members of guilds or unions which bargain collectively with producers on an industry-wide basis from time to time. Any work stoppages or other labor difficulties could delay the production of the films resulting in increased production costs and delayed return of investments.

Business Risks

Film Production

The likelihood of the success of any film and the Company's ability to stay on budget and on schedule for each film must be considered in light of the problems, expenses, difficulties, complications, and delays frequently encountered in connection with the production of a motion picture. Due to unforeseen problems and delays including illness, weather, technical difficulty, and human error, by completion, most films are considerably over budget. In addition, the lack of experience of management in this industry, the limited operating history and capital of the Company, and the competitive environment in which the Company operates may cause increased expenses due to mistakes and delays in the production of the films.

The success of a film in theatrical distribution, television, home video, and other ancillary markets is dependent upon public taste which is unpredictable and susceptible to change. The number and popularity of other films being distributed may also significantly affect the theatrical success of a film. Accordingly, it is impossible for anyone to predict accurately the success of any film at the time it enters production. The production of a motion picture requires the expenditure of funds based largely on a pre-production evaluation of the commercial potential of the proposed project.

Swimwear

The apparel industry is a cyclical industry, with consumer purchases of swimwear, accessory items, and related goods tending to decline during recessionary periods when disposable income is low. Accordingly, a prolonged recession would in all likelihood have an adverse effect on the operations of Breaking Waves and the Company. Breaking Waves operates in only one segment of the apparel industry, specifically swimwear, and is therefore dependent on the demand for such goods. Decreases in the demand for swimwear products would have a material adverse effect on the Company's business as a whole.

Breaking Waves believes that its success in the swimwear industry depends in substantial part on its ability to anticipate, gauge, and respond to changing consumer demands and fashion trends in a timely manner. Breaking Waves attempts to anticipate consumer preferences. There can be no assurance, however, that it will be successful in this regard, and if it misjudges the market for any of its products, it may be faced with unsold finished goods, inventory, and work in process, which could have an adverse effect on the Company's operations as a whole.

ITEM 2. DESCRIPTION OF PROPERTY

The Company's executive offices are located at 14 East 60th Street, Suite 402, New York, New York 10022, (212) 688-9223, comprising approximately 1,800 square feet. The Company leased its office space in November 1996 for a term of five years, at an approximate base annual rental of $70,000. Upon the lease's expiration on November 30, 2001, the executive offices will relocate to Breaking Waves' facilities described below.

Breaking Waves maintains its executive offices and showroom at 112 West 34th Street, New York, New York 10120. Until January 1998, this space was approximately 1,000 square feet and comprised only office space. In January 1998, Breaking Waves amended its lease and rented an additional 1,000 square feet. The lease is for a term of seven years, expiring December 2004, at an annual rental of $71,600. In July 2001, Breaking Waves terminated this lease, effective August 31, 2001. A new 6-year lease for an aggregate of 2,200 square feet expiring September 30, 2007 was signed, which becomes effective on November 1, 2001, or such later date as the landlord of such premises completes construction. 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.

ITEM 3. 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 Company has responded to the complaint and denied the allegations. The Company intends to contest this action vigorously and believes that such claims against it are baseless and without merit.

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.

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

Not applicable.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

Market Information

The Company's Common Stock is quoted on the SmallCap Market of the Nasdaq Stock Market and the Third Segment of the Frankfurt Stock Exchange. The following table sets forth representative high and low sale prices as reported by a market maker for the Company's Common Stock and Warrants, during the period from January 1, 1999 through October 10, 2001. Sales prices reflect prices between dealers and do not include resale mark-ups, mark-downs, or other fees or commissions.

	Common Stock		War
Calendar Period	Low	High	Low
1999(1)(2)			

01/01/99 - 03/31/99	.50	2.78	.03
04/01/99 - 06/30/99	1.06	3.09	.06
07/01/99 - 09/30/99	2.06	2.75	.13
10/01/99 - 12/31/99	2.06	3.44	.13
2000(2)			
01/01/00 - 03/31/00	2.56	7.72	.13

04/01/00 - 06/30/00	2.44	5.13	.13
07/01/00 - 09/30/00	2.38	3.98	.25
10/01/01 - 12/31/00	.25	3.00	.16
2001(2)			
01/01/01 - 03/31/01	.19	.89	.09
04/01/01 - 06/30/01	1.00	2.18	.14
07/01/01 -10/10/01	.42	1.56	.02

As of October 10, 2001, there were 47 holders of record of the Company's Common Stock, although the Company believes that there are approximately 900 additional beneficial owners of shares of Common Stock held in street name. As of October 10, 2001, the number of outstanding shares of the Company's Common Stock was 7,472,224. (This number includes an aggregate of 2,420 shares of Common Stock being held by the Company on behalf of certain shareholders pending their submission for exchange of stock certificates outstanding on the date of the Company's one-for-three reverse stock split, as adjusted for the reverse stock split and subsequent stock dividends.

1 The above prices reflect the price for post-split shares and post-adjustment Warrants.

2 The table reflects the price for post-dividend shares and post-adjustment Warrants since February 5, 1999.

Initially, each Warrant issued in the IPO 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 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 effected 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 February 1999 100% Common Stock dividend, February 2000 10% Common Stock dividend and June 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 or, each Warrant, exercisable at an exercise price of $3.87 purchases 1 share of Common Stock.

In August 2001, the Company extended the term of the Warrants for an 18 month period. The current expiration date of the Warrants is March 10, 2003. There is no current Registration Statement on file with the Securities and Exchange Commission ("SEC") covering the shares of Common Stock issuable upon exercise of the Warrants. Accordingly, the Warrants cannot currently be exercised. The Company plans to file a Registration Statement with the SEC in the future.

On April 15, 1998, the Company's Board of Directors authorized the distribution of Distribution Warrants to all holders of shares of the Company's Common Stock as of the May 8, 1998 Warrant Record Date. Pursuant to the distribution, each share held on the Warrant Record Date shall generate the issuance of one Distribution Warrant to purchase one share of Common Stock at an exercise price of $4.00 per share. The Distribution Warrants, which are exercisable for a period of three years commencing one year after issuance, shall be issued and distributed once the Company has filed a registration statement for same and same has been declared effective by the SEC. The Company to date has not filed the registration statement.

Common Stock Dividends

20% Common Stock Dividend

On May 8, 2000, the Company's Board of Directors authorized the issuance of a 20% stock dividend to all holders of shares of the Company's Common Stock, par value $0.001 per share (the "Common Stock") as of May 19, 2000 payable on June 19, 2000.

10% Common Stock Dividend

On January 7, 2000, the Company's Board of Directors authorized the issuance of a 10% stock dividend to all holders of Common Stock as of January 20, 1999, payable February 1, 2000.

100% Common Stock Dividend

On January 14, 1999, the Company's Board of Directors authorized the issuance of a stock dividend to all holders of shares of the Company's Common Stock as of January 29, 1999, payable on February 5, 1999.

The Company has paid no cash dividends and has no present plan to pay any cash dividends. Payment of future dividends will be determined from time to time by its board of directors, based upon its future earnings, if any, financial condition, capital requirements, and other factors. The Company is not presently subject to any contractual or similar restriction on its present or future ability to pay such dividends.

Recent Sales of Unregistered Securities

In February 1998, in private transactions, the Company sold an aggregate of 792,000 shares of Common Stock to three entities at a price of $0.295 per share for an aggregate price of $195,000. These shares were purchased by the following accredited investors: Full Moon Development, Inc., Volcano Trading, Inc., and American Telecom Corp. See "Security Ownership of Certain Beneficial Owners and Management." The private offering was conducted in reliance upon Rule 506 of the General Rules and Regulations under the Act. The proceeds from these sales were used by the Company for general working capital and to fund the Company's interest in Battle Studies. No underwriter was used in connection with this offering.

In April 1998, in private transactions, the Company sold an aggregate of 924,000 shares of Common Stock to three entities at a price of $0.73 per share for an aggregate price of $560,000. These shares were purchased by the following accredited investors: Amir Overseas Capital, Ltd., HDS Capital Corp. (whose secretary is related to the Company's President), and Galit Capital, Ltd. See "Security Ownership of Certain Beneficial Owners and Management." The private offering was conducted in reliance upon Rule 506 of the General Rules and Regulations under the Act. The proceeds from these sales were used by the Company for general working capital and to fund the Company's interest in Battle Studies. No underwriter was used in connection with this offering.

In February 2000, in a private transaction, the Company sold 120,000 shares of Common Stock to Value Management & Research, AG for an aggregate price of $300,000. The private offering was conducted in reliance upon Rule 506 of the General Rules and Regulations under the Act. The proceeds from the sale were used by the Company for general corporate purposes. No underwriter was used in connection with this offering.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS
CAUTIONARY STATEMENTS ON FORWARD-LOOKING STATEMENTS

Statements contained in this report which are not historical facts 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 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 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 June 30, 2001 and 2000 and at December 31, 2000 and 1999 include 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.

Six months ended June 30, 2001 as compared to the six months ended June 30, 2000

Breaking Waves

For the six months ended June 30, 2001 and 2000, Breaking Waves generated net sales of $4,728,948 and $3,673,770, respectively, with related cost of sales amounting to $3,303,919 and $2,491,788, respectively. The increase in sales amounting to $1,055,178, or approximately 29%, from 2000 to 2001 was primarily attributable to the new Gottex and Coral Cove lines. The gross profit for the six months ended June 30, 2001 amounted to $1,425,029, or 30%, as compared to the six months ended June 30, 2000 during which it amounted to $1,181,982, or 32%. The decrease of 2% is due to higher production costs.

Selling, general, and administrative expenses during the six months ended June 30, 2001 and 2000 amounted to $1,216,127 and $813,416, respectively. The increase amounting to $402,711 or approximately 50%, is primarily attributable to higher warehousing costs and royalty and consulting expense related to the Gottex license agreement. As a percentage of sales, selling, general and administrative expenses increased to 26% from 22% for the six months ended June 30, 2001 and 2000, respectively.

The major components of the Breaking Waves selling, general, and administrative expenses are as follows for the six months ended June 30:

		2001		2000
Officers, office staff and designer salaries and related benefits	$	225,242	$	262,0
Commission expense		149,992		64,4
Warehousing costs		240,858		151,2
Royalty fees		176,610		99,1
Rent expense		44,200		40,9
Factor commissions		55,166		39,9
Miscellaneous general corporate overhead expenses		324,059		155,6

Interest expense in connection with its factoring agreement amounted to $256,429 and $168,115, for the six months ended June 30, 2001 and 2000, respectively. The increase is due to the increase in sales.

In November 1998, Breaking Waves purchased 1,400,000 shares of Play Co. Toys & Entertainment Corp. ("Play Co.") for a total of $504,000 comprised of $300,000 in cash and by shipping $204,000 in merchandise. After the initial purchase, Breaking Waves owned 25.4% of the outstanding common stock of Play Co.

During the six months ended June 30, 2000, certain Play Co. preferred shareholders converted their Series E Convertible Preferred Stock into Play Co.'s common stock thereby diluting Breaking Waves' ownership interest in Play Co. The percentage ownership of Breaking Waves' investment was diluted to approximately 1.5% of June 30, 2001. Breaking Waves accounted for its investment in Play Co. in accordance with the equity method of accounting to the point it maintained at least a 20% ownership interest. Once its investment was below 20%, Breaking Waves accounted for the investment in accordance with the cost method of accounting which valued the investment at $- 0 - due to the prior equity losses in Play Co.'s operations. In accordance with SFAS No. 115 "Accounting for certain investments in debt and equity securities," since such securities are classified as available for sale, the value of such investment was revalued and recorded at the fair market value which was approximately $6,350 and $267,000 as of June 30, 2001 and 2000, respectively. Accordingly, Breaking Waves recorded an unrealized (loss) gain of ($101,600) and $266,700 for the six months ended June 30, 2001 and 2000, respectively, which has been recorded as a component of comprehensive income (loss) in the statements of operations.

Breaking Waves generated net (loss) income of ($84,561) and $180,246 for the six months ended June 30, 2001 and 2000, respectively. The loss generated during the six months ended June 30, 2001 is primarily attributable to a lower gross profit percentage, higher interest expense and warehousing costs and a new consulting agreement.

Breaking Waves' comprehensive loss was $186,161 for the six months ended June 30, 2001 versus comprehensive income of $446,946 for the six months ended June 30, 2000.

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 six months ended June 30, 2001 and 2000, Hollywood generated no sales from its motion picture "Dirty Laundry". Although sales prior to and including the six months ended June 30, 2001 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." There can be no assurance that the Company's new marketing and distribution strategies will be successful in generating sales from "Dirty Laundry." Upon a review of the net realizable value of the movie costs, management has determined that a $145,272 and $100,000 write down was necessary as of June 30, 2001 and 2000, respectively. Accordingly, Hollywood generated a loss of $149,270 and $100,000 for the six months ended June 30, 2001 and 2000.

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 six months ended June 30, 2001 and 2000, Shopnet generated minimal income comprised of interest from its money market and other ancillary revenue from its corporate office.

Shopnet's selling, general, and administrative expense amounted to $283,581 and $283,244 for the six months ended June 30, 2001 and 2000, respectively. This represents an increase of $337, or less than 1%.

The major components of the Company's expenses are as follows for the six months ended June 30:

	2001	2000
Salaries (officer and office staff) and stock compensation and related benefits	$ 93,454	$
Rent	39,286	
Legal and professional fees	54,529	
Consulting fees	15,750	
Other general corporate and administrative expenses	80,562	

Shopnet generated a net loss of $285,838 and $283,692 for the six months ended June 30, 2001 and 2000, respectively. These net losses include on a consolidated basis amortization of goodwill of $35,476 in each period.

Year ended December 31, 2000 as compared to the year ended December 31, 1999

Breaking Waves

For the years ended December 31, 2000 and 1999, Breaking Waves generated net sales of $5,713,133 and $4,756,497, respectively, with related cost of sales amounting to $3,764,258 and $3,214,704, respectively. The increase in sales amounting to $956,636, or approximately 20%, from 1999 to 2000 was primarily attributable to the introduction of the new Coral Cove product line. The gross profit for the year ended December 31, 2000 amounted to $1,948,875, or 34%, as compared to the year ended December 31, 1999 during which it amounted to $1,541,793, or 32%.

Selling, general, and administrative expenses during the years ended December 31, 2000 and 1999 amounted to $1,638,809 and $1,503,993, respectively. The increase, amounting to $134,816 or approximately 9%, is primarily attributable to factoring and warehousing costs. As a percentage of sales, selling, general, and administrative expenses decreased to 29% from 32% for the years ended December 31, 2000 and 1999.

The major components of the Breaking Waves' selling, general, and administrative expenses are as follows for the years ended December 31:

	2000	1999
Officers, office staff and designer salaries and related benefits	$ 535,137	$ 499,64
Commission expense	94,489	112,47
Warehousing costs	228,934	178,47
Royalty fees	171,869	173,70
Rent expense	87,690	96,40
Factor commissions	56,683	50,95
Miscellaneous general corporate overhead expenses	464,007	392,33

Interest expense in connection with its factoring agreement amounted to $305,309 and $228,772, for the years ended December 31, 2000 and 1999, respectively. The increase is due to the increase in sales.

In November 1998, Breaking Waves purchased 1,400,000 shares of Play Co. Toys & Entertainment Corp. ("Play Co.") for a total of $504,000 comprised of $300,000 in cash and by shipping $204,000 in merchandise. After the purchase, Breaking Waves owned 25.4% of the outstanding common stock of Play Co.

For the year ended December 31, 1999, Breaking Waves recognized $994,305 of equity loss (non-cash loss) in Play Co. in connection with the equity method of accounting.

During the year ended December 31, 2000, certain Play Co. preferred shareholders converted their Series E Convertible Preferred Stock into Play Co's common stock thereby diluting Breaking Waves ownership interest in Play Co. The percentage ownership of Breaking Waves' investment was diluted to approximately 1.5% as of December 31, 2000. Breaking Waves accounted for its investment in Play Co. in accordance with the equity method of accounting to the point it maintained at least a 20% ownership interest. Once its investment was below 20%, Breaking Waves accounted for the investment in accordance with the cost method of accounting which valued the investment at $-0- due to the prior equity losses in Play Co.'s operations. In accordance with SFAS No. 115 "Accounting for certain investments in debt and equity securities," since such securities are classified as available for sale, the value of such investment was revalued and recorded at the fair market value which was approximately $108,000 as of December 31, 2000. Accordingly, Breaking Waves recorded an unrealized gain of approximately $108,000 for the year ended December 31, 2000, which has been recorded as a component of comprehensive income (loss) in the statements of operations.

Breaking Waves generated a net income (loss) of $663 and ($1,025,449), for the years ended December 31, 2000 and 1999, respectively. The net loss generated for the year ended December 31, 1999 includes an equity loss (non - cash loss) of $994,305 from Play Co.

Breaking Waves' comprehensive income was $108,613 for the year ended December 31, 2000 versus a comprehensive (loss) of $1,025,449 for the year ended December 31, 1999. The comparisons of the comprehensive net income (loss) for the two years excluding the affect of the investment in Play Co. are $663 for 2000 and ($31,144) for 1999.

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 years ended December 31, 2000 and 1999, Hollywood generated no sales from its motion picture "Dirty Laundry". Although sales prior to, and including, the year ended December 31, 1999 were minimal, the Company expects to effect increased sales during 2001 and thereafter as a result of a new marketing strategy which, among other things, emphasizes the development of new marketing and distribution arrangements for "Dirty Laundry." There can be no assurance that the Company's new marketing and distribution strategies will be successful in generating sales from "Dirty Laundry." Upon a review of the net realizable value of the movie costs, management determined that a $308,564 and $261,000 write down was necessary as of December 31, 2000 and 1999, respectively. Accordingly, Hollywood generated a loss of $314,064 and $265,153 for the years ended December 31, 2000 and 1999, respectively. Subsequent to "Dirty Laundry," Hollywood also has invested in other movie ventures, none of which have generated revenue to date. See "Investment in Joint Ventures."

Shopnet.com

For the years ended December 31, 2000 and 1999, Shopnet generated minimal income comprised of interest from its money market and other ancillary revenue from its corporate office.

Shopnet's selling, general, and administrative expense amounted to $554,434 and $630,014 for the years ended December 31, 2000 and 1999, respectively. This represents a decrease of $75,580, or approximately 12%.

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

	2000	
Salaries (officer and office staff) and stock compensation and related benefits	$ 192,135	$
Rent	76,234	
Legal and professional fees	99,610	
Consulting fees	27,080	
Other general corporate and administrative expenses	159,375	

Shopnet generated a net loss of $593,575 and $685,477 after an income tax (benefit) expense of ($8,140) and $53,369 for the years ended December 31, 2000 and 1999, respectively. Those net losses include on a consolidated basis amortization of goodwill of $70,952 in each year. The income tax expense in 1999 was primarily a result of an increase in the valuation allowance associated with some of the Company's federal net operating losses. The Company has a consolidated net operating loss carryforward of approximately $2,148,000 for federal tax purposes which is expected to be utilized in the future as a result of filing consolidated federal income taxes with its subsidiaries, Breaking Waves and Hollywood.

Liquidity and Capital Resources

At June 30, 2001, the Company's consolidated working capital amounted to $159,203. The Company anticipates that its current available cash will be sufficient for the next twelve months and does not anticipate any cash shortfalls. Breaking Waves' ownership interest in Play Co. amounted to approximately 1.5% as of June 30, 2001 as evidenced by the 1,270,000 shares of common stock it currently owns. As of June 30, 2001, Breaking Waves' investment in Play Co. decreased to $6,350 based on the fair market value of its common stock holdings. On March 28, 2001, Play Co. and certain of its subsidiaries all filed for protection under Title 11 of the United States Code with the United States Bankruptcy Court for the Southern District of New York. In August 2001, the case was converted to a Chapter 7 filing.

The Company considers highly liquid investments with maturities of three months or less at the time of purchase to be cash equivalents. Included in cash are certificates of deposit of approximately $750,000. The Company maintains cash deposits in accounts which are in excess of Federal Deposit Insurance Corporation limits by approximately $665,000. The Company believes that such risk is minimal. The Company maintains a letter of credit with a financial institution as a condition of its factoring agreement. The financial institution initially required the Company to maintain $1,150,000 as collateral for the letter of credit. In September 2001, this was increased to 1,450,000. At June 30, 2001, the $750,169 of the Company's certificates of deposit represented a portion of the $1,150,000 required collateral. Subsequent to September 15, 2001, approximately $400,000 of the Company's certificates of deposit represented a portion of the $1,450,000 required collateral.

In addition, during 1999, Breaking Waves was required to transfer a $200,000 cash deposit to its factoring agent as additional collateral. Accordingly, both cash amounts are designated as restricted.

For the six months ended June 30, 2001 and 2000 and for the years ended December 31, 2000 and 1999, the Company reported consolidated net income (loss) of ($519,669),($203,446), ($906,976) and ($1,976,079) after an income tax (benefit) provision of ($456), $10,970, ($6,004) and $12,273 and a comprehensive net (loss) income of ($621,269), $63,254, ($799,026), and ($1,976,079), respectively.

Investment in Joint Ventures

Battle Studies Productions, LLC

In April 1998, the Company entered into a co-production agreement with North Fork 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 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. 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 costs incurred by same, any remaining proceeds shall be distributed 50% to North Folk and 50% to the Company. The film was shown in January 1999 in both New York and at the Brussels Film Festival.

The Company accounts for the investment in Battle Studies on the equity method. For the six months ended June 30, 2001 and 2000 and for the years ended December 31, 2000 and 1999, the Company recorded $1,473, $-0-, $4,290 and $-0-, respectively, equity losses for its proportionate share of Battle Studies. No revenues have been derived from this film as of June 30, 2001 and December 31, 2000.

On October 12, 2000, Battle Studies entered into a distribution agreement with Raven Pictures International ("Raven Pictures") to distribute Battle Studies' motion picture ("Machiavelli 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 revenue derived from foreign countries less $20,000 for marketing and advertising expenses.

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.

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 June 30, 2001 $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. As of June 30, 2001, 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 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 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. Interest expense related to this agreement totaled $204,821 and $228,772 for the years ended December 31, 2000 and 1999, respectively. As of June 30, 2001 and December 31, 2000, the net due to Breaking Waves from CIT amounted to $-0- and $312, respectively. On or about September 12, 2000 the agreement with CIT was cancelled and a new factoring agreement was entered into with Century Business Credit Corporation ("Century").

Century Business Credit Corporation

On or about September 12, 2000, Breaking Waves entered into a factoring and revolving inventory loan and security agreement with Century to sell their 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 a 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 its investment in Play Co. which is represented by 1,270,000 shares of Play Co.'s common stock. In September 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.

To date, standby letters of credit in the aggregate amount of $1,050,000 secured by assets of third parties have been provided to the Company. This has enabled the Company to reduce the amount of cash in the segregated account, enabling it to utilize such funds for operations. Such assets 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, 200l, 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. On the closing date, such entities received funds in the aggregate amount of $36,750 reflecting advance payment of such amounts. See "Certain Relationships and Related Transactions" for a more complete description of such transactions and the Company's related financial obligations.

In September 2001, the Company and Breaking Waves retained Arc Financial Corp. ("ARC") , a British Virgin Islands 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 ("Financing"), as well as consult with the Company with regard to its ongoing operations, including systems to control expenses, methods to enhance and 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, 2001 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. On the closing date of the financing of the assets in the amount of $1,050,000, 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.

Interest expense related to the factoring agreement totaled $256,429 and $100,488 for the six months ended June 30, 2001 and for the year ended December 31, 2000, respectively. Century has a continuing interest in Breaking Waves' inventory as collateral for the advances. As of June 30, 2001 and December 31, 2000, the net advances to Breaking Waves from Century amounted to $1,700,337 and $3,165,597.

Capital Lease Obligations

During 1998, the Company acquired computer equipment and proprietary software for its subsidiary, Breaking Waves, pursuant to the following terms and conditions:

On August 13, 1998, the Company acquired various computer and related components for $28,583 by entering into a capital lease obligation with interest at approximately 9.2% per annum, requiring 48 monthly payments of principal and interest of $762. The lease is secured by the related computer equipment.

On September 13, 1998, the Company acquired proprietary software for $32,923 by entering into a capital lease obligation with interest at approximately 10.9% per annum, requiring 48 monthly payments of principal and interest of $850. The lease is secured by the related software.

Lease Commitments

The Company's executive offices are located at 14 East 60th Street, Suite 402, New York, New York 10022, (212) 688-9223, compromising approximately 1,800 square feet. The Company leased its office space in November 1996 for a term of five years, at an approximate base annual rental of $70,000. Upon the lease's expiration on November 30, 2001, the executive offices will relocate to Breaking Waves' facilities described below.

Breaking Waves maintains its executive offices and showroom at 112 West 34th Street, New York, New York 10120. Until January 1998, this space was approximately 1,000 square feet and compromised only office space. In January 1998, Breaking Waves amended its lease and rented an additional 1,000 square feet. The lease is for a term of seven years, expiring December 2004, at an annual rental of $71,600. In July 2001, Breaking Waves terminated this lease, effective August 31, 2001. A new 6-year lease for an aggregate of 2,200 square feet expiring September 30, 2007 was signed, which becomes effective on November 1, 2001, or such later date as the landlord of such premises completes construction. 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.

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 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 effective July 1, 2001 calls for minimum annual royalties of $50,000 to $87,500 over the life of the extension with options 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 $150,000, $99,113, $163,009 and $162,501 during the six months ended June 30, 2001 and 2000 and during the years ended December 31, 2000 and 1999, respectively.

On October 31, 1996, Breaking Waves entered into a license agreement with North-South Books, Inc. for the exclusive use of certain artwork and text in the making of swimsuits and accessories in the United States and Canada. The agreement expired on March 1, 1999. Breaking Waves recorded royalties totaling $784 under this agreement during the year ended December 31, 1999.

On October 17, 1997, Breaking Waves entered into a license agreement with Kawasaki Motors Corp., U.S.A. with an effective date of July 1, 1997 for the exclusive use of certain trademarks in the making of swimwear in the United States. The fee for the exclusive use of certain trademarks is five percent (5%) of net sales. The agreement expired May 31, 1999 and was not renewed. Breaking Waves recorded royalties under this agreement totaling $10,415 during the year ended December 31, 1999.

During June 2000, Breaking Waves entered into a license agreement with an effective date of November 1, 2000 with Gottex Models Ltd., an 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. Breaking Waves recorded royalties under this agreement totaling $26,610 and $8,859 for the six months ended June 30, 2001 and for the year ended December 31, 2000, respectively.

ITEM 7. FINANCIAL STATEMENTS

See attached Financial Statements.

ITEM 8. CHANGES AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not Applicable.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

Officers and Directors

The following table sets forth the names, ages, and titles of all directors and officers of the Company:

Name	Age	Position
Harold Rashbaum	73	President, CEO, and Director
Jeanne Falletta	43	Secretary and Director
Alain Le Guillou, M.D.	43	Director
James B. Frakes	44	Director
Michael Friedland	63	Director
Debra Riggs	47	Director

The Directors of the Company are elected annually by the stockholders, and the Officers of the Company are appointed annually by the Board of Directors. Vacancies on the Board of Directors may be filled by the remaining Directors. Each current Director and Officer will hold office until the next annual meeting of stockholders or until his successor is elected and qualified. The outside Directors do not receive a Director's fee for their participation as Directors. The outside Directors are Alain Le Guillou, M.D. (Until recently Harold Rashbaum was the father-in-law of Alain Le Guillou, M.D.), James B. Frakes and Debra Riggs. The Corporation does not have key man insurance on the lives of any of its Officers or Directors.

As permitted under the Delaware General Corporation Law, the Company's Certificate of Incorporation eliminates the personal liability of the directors to the Company or any of its shareholders for damages caused by breaches of said directors' fiduciary duties. As a result of such provision, shareholders may be unable to recover damages against directors for actions which constitute negligence or gross negligence or are in violation of their fiduciary duties. This provision in the Company's Certificate of Incorporation may reduce the likelihood of derivative and other types of shareholder litigation against directors.

Harold Rashbaum, age 73, has been the President, Chief Executive Officer and a Director of the Company since January 1997. Since September 1996, he has also been the President, Secretary, and sole Director of Breaking Waves, Inc. ("Breaking Waves"), a New York company which is a wholly-owned subsidiary of the Company. From May 1996 to January 1997, Mr. Rashbaum served as Secretary and Treasurer of the Company. Since September 1996, Mr. Rashbaum has been the Chairman of the Board of Directors of Play Co. Toys & Entertainment Corp. ("Play Co."), a public entity whose Common Stock, Series E Stock and Series E Warrants are quoted on the over-the-counter market on the OTC Bulletin Board. Mr. Rashbaum was a management consultant to Play Co. from July 1995 to September 10, 1996. In May 1998, he was elected as a Director of Toys International, Inc. ("Toys"), a majority-owned subsidiary of Play Co. whose Common stock is traded on the SMAX segment of the Frankfurt Stock Exchange. On March 28, 2001, Play Co., Toys and Play Co. Toys Canyon Country, Inc. ("Play Co. Toys Canyon") each filed for protection under Title 11 of the United States Code with the United States Bankruptcy Court for the Southern District of New York. In August 2001, the case was converted to a Chapter 7 filing. Since February 1996, Mr. Rashbaum has also been the President and a Director of H.B.R. Consultant Sales Corp. ("HBR"), of which his wife is the sole shareholder.

Jeanne Falletta, age 43, was elected a director of the Company in May 2000 and has been its Secretary since February 2000. Since October 1997, Ms. Falletta has been the controller of Breaking Waves where she has been employed since February 1997, initially having been hired as a bookkeeper. From January 1996 to February 1997, Ms. Falletta consulted with various companies as a freelance accountant.

Alain Le Guillou, M.D., age 44, has been a Director and a consultant of the Company since 1996. Since July 1995, Dr. Le Guillou has been a doctor of pediatrics at Montefiore Medical Group. Until recently, Dr. Le Guillou was the son-in-law of Harold Rashbaum.

James Frakes, age 45, has been a Director of the Company since January 1998 and was appointed Chairman of the Company's Audit Committee in June 2000. Since May 2001, Mr. Frakes has been Chief Financial Officer of NTN Communications, Inc. a public company whose common stock trades on the American Stock Exchange, Inc. From July 1997 to May 2001, Mr. Frakes served as Chief Financial Officer and Secretary of Play Co. In August 1997, he was elected as a Director of Play Co. In January 1998, Mr. Frakes was appointed Secretary and Chief Financial Officer of Toys. He was elected as a Director of Toys in May 1998. On March 28, 2001, Play Co., Toys and Play Co. Toys Canyon each filed for protection under Title 11 of the United States Code with the United States Bankruptcy Court for the Southern District of New York. In August 2001, the case was converted to a Chapter 7 filing. From June 1990 to March 1997, Mr. Frakes was Chief Financial Officer of Urethane Technologies, Inc. ("UTI") and two of its subsidiaries, Polymer Development Laboratories, Inc. ("PDL") and BMC Acquisition, Inc. These were specialty chemical companies, which focused on the polyurethane segment of the plastics industry. Mr. Frakes was also Vice President and a Director of UTI during this period. In March 1997, three unsecured creditors of PDL filed a petition for the involuntary bankruptcy of PDL. From 1985 to 1990, Mr. Frakes was a manager for Berkeley International Capital Corporation, an investment banking firm specializing in later stage venture capital and leveraged buyout transactions.

Michael Friedland, age 63, has been a Director of the Company since May 2000. Mr. Friedland has been the Vice President of Design, Marketing and Sales of Breaking Waves since its inception in 1991. Mr. Friedland has over 40 years experience in the children's swimwear industry. Prior to joining Breaking Waves, Mr. Friedland co-founded Making Waves, Inc., a manufacturer of children's swimwear.

Debra Riggs, age 46, has been a Director of the Company since June 2000 when she was also appointed to the Company's Audit Committee. In September 2001, Ms. Riggs joined Premier Food Services Incorporated as a branch controller. Ms. Riggs was the Controller of Play Co. since February, 1999 until September 2001. On March 28, 2001, Play Co., Toys and Play Co. Toys Canyon each filed for protection under Title 11 of the United States Code with the United States Bankruptcy Court for the Southern District of New York. In August 2001, the case was converted to a Chapter 7 filing. From June, 1998 through January, 1999, Ms. Riggs was Controller of National Customer Engineering, a private company. Prior to NCE, Ms. Riggs was Assistant Controller of Factory 2-U Inc., a public company with over 200 retail stores in the business of selling discount clothing.

Compliance with Section 16(A) of the Exchange Act

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's officers, directors, and persons who beneficially own more than ten percent of a registered class of the Company's equity securities to file reports of securities ownership and changes in such ownership with the SEC. Officers, directors, and greater than ten percent beneficial owners also are required by rules promulgated by the Securities and Exchange Commission

("SEC") to furnish the Company with copies of all Section 16(a) forms they file.

No person ("a Reporting Person") who during the six months ended June 30, 2001 was a director, officer, or beneficial owner of more than ten percent of the Company's Common Stock which is the only class of equity securities of the Company registered under ss.12 of the Securities Exchange Act of 1934, as amended, failed to file on a timely basis reports required by ss.16 of the Act except that, to the Company's knowledge, each of Mr. Michael Friedland and Ms. Falletta and Riggs, all directors of the Company, filed their Forms 3 late in March 2001. In addition, to the Company's knowledge, Mr. Rashbaum and Mr. Di Milia (a former officer of the Company) did not file Forms 4 or Forms 5, and EVC did not file a Form 5 for the year ended December 31, 1999. The foregoing is based solely upon a review by the Company of (i) Forms 3 and 4 during the most recent fiscal year as furnished to the Company under Rule 16a-3(e) under the Act, (ii) Forms 5 and amendments thereto furnished to the Company with respect to its most recent fiscal year, and (iii) any representation received by the Company from any reporting person that no Form 5 is required, except as described herein.

ITEM 10. EXECUTIVE COMPENSATION

Summary of Cash And Certain Other Compensation

The following table provides certain information concerning all Plan and Non-Plan (as defined in Item 402 (a)(ii) of Regulation S-B) compensation awarded to, earned by, or paid to the named executive officer during the periods ended December 31, 2000, 1999 and 1998 and the six month period ended June 30, 2001.

SUMMARY COMPENSATION TABLE

		Annual Compensation				Long-Term C
					Awards	
Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compen- sation ($)	Restricted Stock Award(s) ($)	Securities Underlying Options/ SARs (#)
Harold Rashbaum President, CEO, And Director	2000	160,000	--	--	--	--
	1999	162,000	--	--	--	44,000(1)
	1998	156,000	--	--	--	--

(1) Represents an aggregate of 44,000 shares of Common Stock underlying options exercisable at $1.38 per share, granted in April 1999.

(2) Mr. Rashbaum received $70,000 of salary during the six month period ended June 30, 2001.

Stock Options

The following table contains information regarding options to purchase Common Stock held at June 30, 2001 and December 31, 2000 by the Company's executive officer named in the Executive Compensation Table above.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR END OPTION VALUES

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at Fiscal Year End: Exercisable	Number of Securities Underlying Unexercised Options at Fiscal Year End: Unexercisable	Value O Exerc
Harold Rashbaum	(1)	(1)	132,000(2)	--	

(1) No options were exercised in the six month period ended June 30, 2001 or the years ended December 31, 1999 or 2000.

(2) Represents an aggregate of 88,000 shares of Common Stock underlying options granted in March 1997 under the Company's Senior Management Incentive Plan, currently exercisable at $1.46 per share, and an aggregate of 44,000 shares of Common Stock underlying options granted in April 1999, currently exercisable at $1.38 per share.

(3) The options had no value at either June 30, 2001 or December 31, 2000, since as of such dates the aggregate exercise price of the options exceeded the aggregate market value of the underlying shares (based on the closing sales prices of the Company's Common Stock.)

Employment and Consulting Agreements

ShopNet.com, Inc.

Before he became an officer and director of the Company, Harold Rashbaum provided consulting services to the Company through HBR, a company of which he is an officer and director and of which his wife is the sole shareholder. HBR entered into an oral consulting agreement with the Company whereby it will receive 5% of the net profits received by the Company from the distribution of "Dirty Laundry." To date, HBR has not received any fees as a result of the distribution of "Dirty Laundry" not generating any net profits. See "Certain Relationships and Related Transactions."

Breaking Waves, Inc.

In November 1996, Breaking Waves entered into employment agreements with each of Malcolm Becker and Michael Friedland; these agreements expired in November 1999. The agreements initially provided that Messrs. Becker and Friedland each would be compensated at a salary of $110,000 per annum during the term of his agreement and that each would be issued restricted shares of Common Stock, subject to a vesting schedule, annually during the term of his agreement.

In November 1996, 3,667 shares of the Company's Common Stock were issued to each of Messrs. Becker and Friedland, subject to the vesting schedule. In November 1997, 15,888 shares of the Company's Common Stock were issued to each of Messrs. Becker and Friedland, subject to the aforesaid vesting schedule.

In January 1998, Mr. Friedland's employment agreement was amended to provide for an increase in salary to $130,000 per annum, and Mr. Becker's employment agreement was amended to reflect a reduction in the amount of time Mr. Becker would be required to devote to the business of Breaking Waves, a concomitant reduction in salary to $60,000 per annum, and a reduction in the number of shares of Common Stock to be issued. In January 1999, Mr. Becker's employment agreement was further amended to reflect an increase in the amount of time Mr. Becker would be required to devote to the business of Breaking Waves and a concomitant increase in salary to $70,000 per annum.

In each of May and November 2000, pursuant to their respective employment agreements, Messrs. Becker and Friedland received their final share issuances. Mr. Becker received an aggregate of 91,289 shares of Common Stock, 45,644 in May 2000 and 45,645 in November 2000. Mr. Friedland received an aggregate of 167,365 shares of Common Stock, 83,683 in May 2000 and 83,683 in November 2000. Messrs. Becker and Friedland each granted an option to BBC

Capital Corp. ("BBC"), of which Ilan Arbel is President, to purchase an aggregate of 76,074 shares of common stock in the case of Mr. Becker and 139,471 shares in the case of Mr. Friedland, at an exercise price of $4.50 per share. Such options expired to the extent of 1/2 of the underlying shares on May 27, 2001. The balance of the options scheduled to expire in November 2001 were terminated by BBC in August 2001.

Breaking Waves entered into a one-year consulting agreement in August 2000 with Larry Nash, Inc. ("Consultant") a New York corporation, whereby Mr. Nash, the Consultant's sole stockholder provides sales and consulting services in connection with Breaking Waves' Gottex line. Mr. Nash has provided similar services for the past twelve years with another company for which he represented the Gottex children's swimwear line. The agreement is automatically extended from year to year thereafter unless cancelled by either party on thirty (30) days' prior written notice. Pursuant to such agreement, the Consultant is compensated a percentage of net sales (as such term is defined) on all orders exclusively procured by him, ranging from 2.5 to 5%. He is entitled to additional compensation ranging from 1.5% to 3% of net sales for the Coral Cove, Gottex and Breaking Waves lines, generated by Company sales personnel he introduces to the Company.

See "Management's Discussion and Analysis or Plan of Operations--Factoring Agreements-Century Business Credit Corporation" for a description of the Arc Consulting Agreement.

Senior Management Incentive Plan

General

In May 1996, the Board of Directors adopted the Senior Management Incentive Plan (the "Management Plan") which was adopted by shareholder consent. The Management Plan provides for the issuance of an aggregate of 750,000 shares of Common Stock in connection with the issuance of stock options and other stock purchase rights to executive officers, key employees, and consultants.

The Management Plan was adopted to provide the Board of Directors with sufficient flexibility regarding the forms of incentive compensation which the Company will have at its disposal for rewarding executive officers, employees, and consultants (of either the Company or a subsidiary of same) who render significant services to the Company or its subsidiary with equity in the Company through the grant of stock options and other rights. The Management Plan was adopted to enable the Company to attract and retain qualified personnel without unnecessarily depleting the Company's cash reserves (by offering those persons who provide significant services a personal interest in the Company's growth and success) and to augment the Company's existing compensation programs.

The Management Plan is intended also to help the Company attract and retain key executive management personnel whose performance is expected to have a substantial impact on the Company's long-term profit and growth potential by encouraging and assisting those persons to acquire equity in the Company. It is contemplated that only persons who perform services of special importance to the Company will be eligible to participate under the Management Plan. A total of shares of Common Stock have been reserved for issuance under the Management Plan. It is anticipated that awards made under the Management Plan will be subject to three-year vesting periods, although the vesting periods are subject to the discretion of the Administrator (as defined below).

The Management Plan is to be administered by the Board of Directors or a committee of the Board if one is appointed for this purpose (the Board or such committee, as the case may be, will be referred to in the following description as the "Administrator"). Members of the Board of Directors who are eligible for awards or have been granted awards may not vote on any matters affecting the administration of the Management Plan or the grant of any award thereunder. Subject to the specific provisions of the Management Plan, the Administrator will have the discretion to determine the recipients of the awards, the nature of the awards to be granted, the dates such awards will be granted, the terms and conditions of awards, and the interpretation of the Management Plan, except that any award granted to any employee of the Company who is also a director of the Company will also be subject - in the event the Administrator of such plan at the time such award is proposed to be granted does not satisfy the requirements regarding the participation of "disinterested persons" set forth in Rule 16b-3 ("Rule 16b-3") promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act") - to the approval of an auxiliary committee consisting of not less than three individuals (all of whom qualify as "disinterested persons" as defined under Rule 16b-3. In the event the Board of Directors deems the formation of an auxiliary committee impractical, the Board is authorized to approve any award under the Management Plan. As of the date hereof, the Company has not yet determined who will serve on such auxiliary committee, if one is required. The Management Plan generally provides that unless the Administrator determines otherwise, each option or right granted under the plan will become exercisable in full upon certain "change of control" events as described therein.

If any change is made in respect of the Common Stock subject to the Management Plan or subject to any right or option granted under the Management Plan (through merger, consolidation, reorganization, recapitalization, stock dividend, or dividend in property other than cash, stock split, liquidating dividend, combination of shares, exchange of shares, change in corporate structure, or otherwise), the Administrator will make appropriate adjustments to the Management Plan and the number of shares and price per share of Common Stock subject to outstanding rights or options. Generally, the Management Plan may be amended by action of the Board of Directors except that any amendment which would change the class of securities subject to the plan, increase the total number of shares subject to such plan, extend the duration of such plan, materially increase the benefits accruing to participants under such plan, or change the category of persons who can be eligible for awards under such plan must be approved by the affirmative vote of the owners of a majority of the Common Stock entitled to vote. The Management Plan permits awards to be made thereunder until November 2004.

Directors who are not otherwise employed by the Company will not be eligible for participation in the Management Plan. The Management Plan provides for four types of awards: stock options, incentive stock rights, stock appreciation rights (including limited stock appreciation rights), and restricted shares.

Incentive Stock Options ("ISOs" and "non-ISOs")

The Management Plan may be either incentive stock options which qualify as such under the Internal Revenue Code ("ISOs") or options which do not qualify under the Internal Revenue Code as ISOs ("non-ISOs"). ISOs may be granted at an option price of not less than 100% of the fair market value of the Common Stock on the date of grant except that an ISO granted to any person who owns Common Stock representing more than 10% of the total combined voting power of all classes of Common Stock of the Company ("10% Shareholder") must be granted at an

exercise price of at least 110% of the fair market value of the Common Stock on the date of the grant. The exercise price of non-ISOs may not be less than 85% of the fair market value of the Common Stock on the date of grant. The Administrator will determine the exercise period of the options granted which shall be no less than one year from the date of grant. Non-ISOs may be exercisable for a period of up to 13 years from the date of grant. ISOs granted to persons other than 10% Shareholders may be exercisable for a period of up to 10 years from the date of grant; ISOs granted to 10% Shareholders may be exercisable for a period of up to five years from the date of grant. The aggregate fair market value (determined at the time an ISO is granted) of shares of Common Stock that are subject to ISOs held by a plan participant that may be exercisable for the first time during each calendar year may not exceed $100,000.

Payment for shares of Common Stock purchased pursuant to exercise of stock options may be remitted in cash or by certified check or at the discretion of the Administrator (i) by promissory note, (ii) promissory note combined with cash, (iii) by shares of Common Stock having a fair market value equal to the total exercise price, or (iv) by a combination of items (i)-(iii) above. The provision that permits the delivery of already owned shares of stock as payment for the exercise of an option may permit "pyramiding." In general, pyramiding enables a holder to use shares of Common Stock owned in order to pay for the exercise of the stock option. This is done by transferring such shares to the Company as payment of the exercise price for the shares purchased pursuant to the exercise of the Option. The value of such shares shall be determined by the market value of the shares at the time of transfer. Thereafter, the shares received upon the exercise of the option could then be used to do the same. Thereby, the holder may start with as little as one share of Common Stock and use the shares of Common Stock acquired in successive, simultaneous exercises of the option to exercise the entire option, regardless of the number of shares covered thereby, with no additional cash or investment other than the original share of Common Stock used to exercise the option.

Upon termination of employment, an optionee will be entitled to exercise the vested portion of an option for a period of up to three months after the date of termination except that if the reason for termination was a discharge for cause, the option shall expire immediately, and if the reason for termination was death or permanent disability of the optionee, the vested portion of the option shall remain exercisable for a period of 12 months thereafter.

In March 1997, the Company granted to Mr. Rashbaum an option to purchase 88,000 shares of Common Stock at an exercise price of $1.46 per share, pursuant to the Management Plan.

Incentive Stock Rights

Incentive stock rights consist of incentive stock units each of which is equivalent to one share of Common Stock and may be awarded in consideration for services performed for the Company or any subsidiary. Each incentive stock unit shall entitle the holder thereof to receive, without payment of cash or property to the Company, one share of Common Stock in consideration for services performed for the Company or any subsidiary by the employee, subject to the lapse of the incentive periods, at which time the Company will issue one share of Common Stock for each unit awarded upon the completion of each specified period. If the employment with the Company of the holder of the incentive stock units terminates prior to the end of the incentive period relating to the units

awarded, the rights will thereupon be null and void, except that if termination is caused by death or permanent disability, the holder or his heirs, as the case may be, will be entitled to receive a pro rata portion of the shares represented by the units, based upon that portion of the incentive period which has elapsed prior to the death or disability.

Stock Appreciation Rights (SARs)

SARs may be granted to recipients of stock options under the Management Plan. In the discretion of the Board of Directors, SARs may be granted simultaneously with, or subsequent to, the grant of a related stock option and may be exercised to the extent that the related option is exercisable, except that no general SAR (as hereinafter defined) may be exercised within a period of six months of the date of grant of such SAR, and no SAR granted with respect to an ISO may be exercised unless the fair market value of the Common Stock on the date of exercise exceeds the exercise price of the ISO. An option holder may be granted general SARs ("general SARs"), limited SARs ("limited SARs"), or both. General SARs permit the holder thereof to receive - without payment of cash or property to the Company - cash, shares of Common Stock, or a combination of both in an amount determined by dividing (i) that portion, elected by the option holder, of the total number of shares which the holder is eligible to purchase multiplied by the amount, if any, by which the fair market value of a share of Common Stock (on the exercise date) exceeds the option exercise price of the related option by (ii) the fair market value of a share of Common Stock on the exercise date. Limited SARs are similar to general SARs except that, unless the Administrator determines otherwise, limited SARs may be exercised only during a prescribed period following the occurrence of one or more of the following "change of control" transactions: (i) the approval of the Board of Directors and shareholders of the Company of a consolidation or merger in which the Company is not the surviving corporation, the sale of all or substantially all of the assets of the Company, or the liquidation or dissolution of the Company, (ii) the commencement of a tender or exchange offer for the Company's Common Stock (or securities convertible into Common Stock) without the prior consent of the Board, (iii) the acquisition of beneficial ownership by any person or other entity (other than the Company or any employee benefit plan sponsored by the Company) of securities of the Company representing 25% or more of the voting power of the Company's outstanding securities, or (iv) in the event, during any period of two consecutive years or less, individuals who at the beginning of such period constitute the entire Board cease to constitute a majority of the Board, unless the election, or the nomination for election, of each new director is approved by at least a majority of the directors then still in office.

An SAR holder may exercise his SAR rights by giving written notice of such exercise to the Company, which specifies the number of shares of Common Stock involved. The exercise of any portion of either the related stock option or the tandem SARs will cause a corresponding reduction in the number of shares remaining subject to the option or the tandem SARs, thus maintaining a balance between outstanding options and SARs. SARs have the same termination provisions as the underlying stock options (as described above) in the event an SAR holder ceases to be an employee of the Company.

Restricted Stock Purchase Agreements

Restricted share agreements provide for the issuance of restricted shares of Common Stock to eligible participants under the Management Plan. The Board of Directors may determine the price to be paid by the participant for the shares or that the shares may be issued for no monetary consideration. The shares issued shall be subject to restrictions for a stated restricted period during which the participant must remain in the Company's employ in order to retain the shares. Payment may be made in cash, by promissory note, or via a combination of both.

Restricted shares awarded under the Management Plan will be subject to a period of time, designated by the Administrator as the "restricted period," during which the holder has limited rights with respect to such shares. The Administrator may also impose other restrictions, terms, and conditions that must be fulfilled before the restricted shares may vest. Upon the grant of restricted shares, stock certificates registered in the name of the recipient will be issued, and such shares will constitute issued and outstanding shares of Common Stock for all corporate purposes. The holder will have the right to vote the restricted shares and to receive all regular cash dividends (and such other distributions as the Administrator may designate, other than distributions made solely with respect to the restricted shares ("retained distributions"), if any, which are paid or distributed on the restricted shares and, generally, to exercise all other rights as a holder of Common Stock except that until the end of the restricted period: (i) the holder will not be entitled to take possession of the stock certificates representing the restricted shares or receive retained distributions, and (ii) the holder will not be entitled to sell, transfer, or otherwise dispose of the restricted shares. A breach of any restrictions, terms, or conditions established by the Administrator with respect to any restricted shares will cause a forfeiture of such restricted shares.

Upon expiration of the applicable restricted period(s) and the satisfaction of any other applicable conditions, the restricted shares and any dividends or other distributions not distributed to the holder (the "retained distributions") thereon will become vested. Any restricted shares and any retained distributions thereon which do not so vest will be forfeited to the Company. If prior to the expiration of the restricted period a holder's employ is terminated without cause or because of a total disability (in each case as defined in the Management Plan) or the holder dies, unless otherwise provided in the restricted share agreement providing for the award of restricted shares, the restricted period applicable to each award of restricted shares will thereupon be deemed to have expired. Unless the Administrator determines otherwise, if a holder's employment terminates prior to the expiration of the applicable restricted period for any reason other than as set forth above, all restricted shares and any retained distributions thereon will be forfeited. Upon forfeiture of any restricted shares, the Company will repay to the holder thereof any amount the holder originally paid for such shares.

Acceleration of all awards under the Management Plan shall occur, pursuant to the provisions of Section 13 the Management Plan, on the first day following the occurrence of any of the following: (a) the approval by the shareholders of the Company of an "Approved Transaction," (b) a "Control Purchase," or (c) a "Board Change."

An "Approved Transaction" is defined as (i) any consolidation or merger of the Company in which the Company is not the continuing or surviving corporation or pursuant to which shares of Common Stock would be converted into cash, securities, or other property other than a merger of the Company in which the holders of Common Stock immediately prior to the merger have the same proportionate ownership of Common Stock of the surviving corporation immediately after the merger, (ii) any sale, lease, exchange, or other transfer (in one transaction or a series of related transactions) of all, or substantially all, of the assets of the Company, or (iii) the adoption of any plan or proposal for the liquidation or dissolution of the Company.

A "Control Purchase" is defined as circumstances in which any person (as such term is defined in Sections 13(d)(3) and 14(d)(2) of the Exchange Act), corporation, or other entity (other than the Company or any employee benefit plan sponsored by the Company) (i) shall purchase any Common Stock of the Company (or securities convertible into the Company's Common Stock) for cash, securities, or any other consideration pursuant to a tender offer or exchange offer, without the prior consent of the Board of Directors or (ii) shall become the "beneficial owner" (as such term is defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing twenty-five percent (25%) or more of the combined voting power of the then outstanding securities of the Company ordinarily (and apart from rights accruing under special circumstances) having the right to vote in the election of directors (calculated as provided in paragraph (d) of such Rule 13d-3 in the case of rights to acquire the Company's securities).

A "Board Change" is defined as circumstances in which, during any period of two consecutive years or less, individuals who at the beginning of such period constitute the entire Board shall cease for any reason to constitute a majority thereof unless the election, or the nomination for election by the Company's shareholders, of each new director was approved by a vote of at least a majority of the directors then still in office.

Non-Executive Director Stock Option Plan

The Company terminated its Non-Executive Director Stock Option Plan on December 31, 1998, in accordance with the terms thereof.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information as of October 10, 2001 with respect to the beneficial ownership of shares of Common Stock by (i) each person known by the Company to be the owner of more than 5% of the outstanding shares of Common Stock, (ii) each director or director nominee of the Company (iii) each executive officer of the Company for whom information is given in the Summary Compensation Table in this proxy statement and (iv) all officers and directors as a group. Except to the extent indicated in the footnotes to the following table or otherwise as specified in this Proxy Statement, each of the individuals/entities listed below possesses sole voting power with respect to the shares of Common Stock listed opposite his/its name.

[Table on next page]

Name and Address of Beneficial Owner (1)	Number of Shares Beneficially Owned (1)	Percent of Common Owned
European Ventures Corp. P.O. Box 47 Road Town Tortola, BVI	1,783,836(3)(7)	23
Fiduciara Biaggini Via Vanoni # 6 Lugano, Switzerland CH 6901	1,577,396(10)	2
American Telecom Corp.		

C/o MW Todtman McNamara Chamber P.O. Box 47 Road Town Tortola, BVI	594,000(4)(5)(6)(7)	8.
HDS Capital Corp. C/o MW Todtman McNamara Chamber P.O. Box 47 Road Town Tortola, BVI	330,000(6)(7)	4.
Amir Capital Overseas Ltd. P.O. Box 47 Road Town Tortola, BVI	303,600(8)	4.
Volcano Trading Inc. C/o Valor Invest Via Cantalone 16 6900 Lugano, Switzerland	250,800 (8)	3.
Full Moon Development Corp. C/o Valor Invest Via Cantalone 16 6900 Lugano, Switzerland	277,200(8)	3.
Galit Capital, Ltd. Via Vanoni #6 Lugano, Switzerland CH 6901	290,400(8)	3.
Harold Rashbaum	252,000(9)	3.
Jeanne Falletta	--	-
Alain Le Guillou, M.D.	--	-
James Frakes	--	-
Michael Friedland	167,720	2.
Debra Riggs	--	-
All Officers and Directors as a Group (six persons)	419,720(9)	5.

* Less than 1% of the outstanding common stock.

(1) Unless otherwise indicated, the address for each listed director or officer is c/o ShopNet.Com, Inc., 14 East 60th Street, New York, New York 10022. As used in this table, "beneficial ownership" means the sole or shared power to vote or direct the voting or to dispose or direct the disposition of any security. For the purposes of this table, a person is deemed to be the beneficial owner of securities that can be acquired within 60 days from February 1, 2001 through the exercise of any option or warrant. Shares of Common Stock subject to options or warrants that are currently exercisable or exercisable within 60 days are deemed outstanding for computing the ownership percentage of the person holding such options or warrants, but are not deemed outstanding for computing the ownership percentage of any other person. The amounts and percentages are based upon 7,472,224 shares of common stock outstanding as of October 10, 2001.

(2) Does not give effect to the issuance of (i) 3,379,200 shares of Common Stock issuable upon exercise of the 3,840,000 outstanding Warrants (the exercise of each warrant at an exercise price of $3.41 purchases .88 of a share of Common Stock) or (ii) 128,333 shares of Common Stock reserved for

issuance under the Company's Senior Management Incentive Plan.

(3) Includes an aggregate of 2,112 shares of common stock underlying 2,400 warrants. Each warrant is exercisable at a purchase price of $3.41 for .88 of a share of Common Stock. European Ventures Corp. ("EVC") is formed under the laws of the British Virgin Islands. Mr. Ilan Arbel, son-in-law of Harold Rashbaum, President, Chief Executive Officer and a director of the Company, was President of EVC until May 2001, when he resigned.

(4) American Telecom Corp. ("ATC") is a corporation organized under the laws of the British Virgin Islands which is wholly-owned by Europe American Capital Foundation ("EACF"), a Liechtenstein Trust with an address at Pradafont Street #7, Vaduz Liechtenstein, c/o Dr. Wohlwerd. Mr. Arbel controlled EACF through October 2000 and has been President of ATC since July 2000. By virtue of his position with ATC, Mr. Arbel has voting and dispositive control over shares of the Company beneficially owned by ATC and therefore may be deemed to beneficially own such shares.(5) Includes 330,000 shares owned by HDS Capital Corp. ("HDS"), a Company organized under the laws of the British Virgin Islands, which is wholly-owned by ATC.

(6) Mr. Arbel is President of HDS and by virtue of such position and his control over ATC (see footnote (4) above), Mr. Arbel has voting and dispositive control over shares of the Company beneficially owned by HDS and therefore may be deemed to beneficially own such shares.

(7) Shares of the Company beneficially owned by EVC, ATC and HDS are held of record in the name of "Fiduciara Biaggini, as trustee" ("Fiduciara Biaggini"), on behalf of such respective entities which have retained beneficial ownership of such shares. Fiduciara Biaggini is a fiduciary company with an address at via Vanoni #6, Lugano, Switzerland CH 6901.

(8) Shares of the Company beneficially owned by each of Amir Capital Overseas Ltd. ("Amir"), Volcano Trading Inc. ("Volcano"), Full Moon Development Corp. ("Full Moon") and Galit Capital Ltd ("Galit"), all companies organized under the laws of the British Virgin Islands, are held of record in the name of "Fiduciara Biaggini, as trustee," on behalf of such respective entities. Fabio Rossi, a manager of Fiduciara Biaggini, is the President and sole director of each such entity. Accordingly, Mr. Rossi by virtue of such positions, may have voting and dispositive control over shares of the Company owned by each of Amir, Volcano, Full Moon and Galit and therefore may be deemed to be the beneficial owner of such shares, representing in the aggregate 15.1% of the Company's outstanding Common Stock.

(9) Includes an aggregate of 132,000 shares of Common Stock underlying options granted to Mr. Rashbaum, the Chairman of the Board, President and Chief Executive Officer of the Company. See "Executive Compensation.

(10) Does not include shares of Common Stock identified in footnotes (7) or (8).

By virtue of Mr. Arbel's voting and dispositive control of shares of the Company owned by each of ATC and HDS (see footnotes 4, 5 and 6 above), Mr. Ilan Arbel may be deemed to beneficially own 8% of the Company's outstanding Common Stock.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Breaking Waves' Loan and Security Agreement with Century Business Credit Corporation ("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. Pursuant to the terms of a Reimbursement and Compensation Agreement ("Reimbursement and Compensation Agreement"), a trust ("Trust"), the beneficiary of which is the granddaughter of Harold Rashbaum, the Company's Chairman of the Board, President and Chief Executive Officer, and the daughter of Mr. Arbel, a principal stockholder, provided the security underlying a letter of credit in the amount of $250,000 issued by a bank to replace a portion of a letter of credit previously provided by the Company. 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 the issuing bank makes payment and then 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. Breaking Waves paid a fee of $42,500 to the Trust and reimbursed the Trust for all related professional and other fees incurred by the Trust in connection with such transaction.

On May 3, 2001, the Company, Breaking Waves and the Trust entered into a First Amendment to Reimbursement and Compensation Agreement ("Amendment") pursuant to which the Trust increased the amount of security an additional $150,000 for a total of $400,000, including the original $250,000. The Trust conditioned the additional $150,000 of security upon the receipt of an additional Guaranty from a party satisfactory to it. Gal Capital Corp. ("Gal") provided a Guaranty agreeing to pay all obligations of Breaking Waves as contained in the original Reimbursement and Compensation Agreement and all related expenses in enforcing same. Gal received a fee of $42,500 for the issuance of such guaranty. Mr. Arbel is President of Gal.

In September, 2001, Century increased the required security in the form of letters of credit from $1,150,000 to 1,450,000. The Company also sought to raise additional funds to secure the letter of credit in order to have available to it additional working capital.

Pursuant to an Amended and Restated Reimbursement and Compensation Agreement dated as of September 15, 2001, between the Trust and Breaking Waves, which superceded the original Reimbursement and Compensation Agreement, the Trust agreed to provide additional security to a bank in return for the issuance of a letter of credit from such bank to Century in the amount of $350,000 (in addition to the original $400,000) to replace a portion of a letter of credit previously provided by Shopnet in a similar amount. The Trust agreed to continue such letter of credit for a period of ten years, absent any default. The terms include the same reimbursement, guarantee and security provisions as in the original Reimbursement and Compensation Agreement. As compensation, the Trust is entitled to .83 percent of net sales of Breaking Waves through June 30, 2001, and 1.16% of net sales of Breaking Waves for each year thereafter ("Trust L/C Fees"). Such amounts are payable 45 days after the close of each fiscal quarter. On the closing date, Breaking Waves paid $24,500 to the Trust as an advance of future Trust L/C Fees and reimbursed the Trust for all related professional fees.

In addition, Breaking Waves entered into a Reimbursement Agreement dated as of September 15, 2001 with Rivka and Yair Arbel ("RAYA") (Mr. Arbel's brother and sister-in-law), pursuant to which RAYA agreed to provide security to a bank in return for a letter of credit from such bank to Century in the amount of $300,000 reflecting the increase of security required by Century. RAYA agreed to continue such letter of credit for a period of ten years, absent any default. The Reimbursement Agreement includes reimbursement provisions in favor of the Trust in the event the letter of credit is called by Century and is paid by the bank. All of Breaking Waves obligations are guaranteed by Shopnet and secured by Shopnet's assets. As compensation, RAYA is entitled to a fee equal to .42 percent of net sales of Breaking Waves through June 30, 2001 and .58 percent of net sales of Breaking Waves thereafter ("RAYA L/C Fees"). Such amounts are payable forty-five days after the close of each fiscal quarter. On the closing date, Breaking Waves paid $12,250 to RAYA as an advance of future RAYA L/C Fees and reimbursed RAYA for all related professional fees.

In August 2000, Breaking Waves received an $80,000 advance from Play Co. against future orders of merchandise. No orders were received against this advance and in December 2000 Breaking Waves repaid the full $80,000 to Play Co.

In November 1999, Breaking Waves borrowed $400,000 from Play Co. with such loan bearing interest at 9% per annum. Breaking Waves repaid $100,000 of the loan in January 2000 and the balance in April 2000.

In October 1999, the Company borrowed $50,000 from Play Co. and Breaking Waves borrowed $200,000 from Play Co. The loans bore interest at 9% and were repaid in March 2000.

In February 1999, the Company loaned $100,000 to Play Co. with such loan bearing interest at 9% per annum. In each of April and May 1999, the Company loaned an additional $100,000 to Play Co. at an interest rate of 9% per annum. All such loans have been repaid.

In November 1998, pursuant to a sales agreement entered into between Breaking Waves and Play Co., Breaking Waves purchased 1.4 million unregistered shares of Play Co.'s common stock in a private transaction, which was subsequently reduced to 1,270,000 shares. The shares purchased represented approximately 25.4% of the outstanding common stock of Play Co. immediately after the transaction. Such percentage has since been reduced to approximately 1.5% of Play Co.'s outstanding common stock. Pursuant to the agreement which bore an initial term of one year and automatically extended for an additional one year term since it was not terminated by either of the parties - Play Co.

agreed to purchase (on a wholesale basis) a minimum of 250 pieces of merchandise for each of its retail locations and to provide advertising promotional materials and ads of the merchandise in all of its brochures, advertisements, catalogs, and all other promotional materials, merchandising programs, and sales promotion methods. Breaking Waves had previously sold a limited number of pieces of its swimwear to Play Co. As consideration for the stock, Breaking Waves remitted $504,000, which represented an approximate price of $0.36 per share: $300,000 of the consideration was remitted in cash, and the remaining $204,000 was provided in the form of merchandise, primarily girls' swimsuits.

In October 1996, pursuant to a promissory note, the Company loaned Harold Rashbaum its President and Chief Executive Officer a total of $50,000 bearing interest at 6 1/2% payable over three years. As of June 30, 2001, the unpaid portion, which is due on demand, amounted to $37,000, which has been classified as current. In 1998, 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.

Before he became an Officer and Director of the Company, Mr. Rashbaum provided consulting services to the Company through HBR, a company of which he is an officer and director and of which his wife is the sole shareholder. In 1996, HBR entered into an oral consulting agreement with the Company providing for the payment to HBR of 5% of the net profits received by the Company from the distribution of "Dirty Laundry." To date, HBR has not received any fees as a result of the distribution of "Dirty Laundry" not generating any net profits.

Alain Le Guillou, a director of the Company, has been a consultant to the Company since 1996. Prior to July, 2001, he received $12,000 per annum for such services which was subsequently reduced to $6,000 per annum. Until recently, Dr. Le Guillou was the son-in-law of Harold Rashbaum.

During the six months ended June 30, 2001 and years ended December 31, 2000 and 1999 the Company paid $24,000, $49,080 and $24,000 respectively, in financial consulting fees to DRA Consulting, Inc., a company whose president is the daughter of the Company's Chairman of the Board, President, Chief Executive Officer.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following financial statements of the Company are included as Part II, Item 8:

(b) On July 9, 2001, the Company filed a Form 8-K changing the Company's fiscal year-end to June 30.

(c) The following exhibits which are designated by an asterisk (*) are to be filed by amendment. Exhibits not so designated previously were filed with the Securities and Exchange Commission with either (i) the Registration Statement on Form SB-2, file no. 333-5098-NY, (ii) the Registration Statement on Form SB-2, file no. 333-5098-NY, Post-Effective Amendment No. 1, (iii) the Registration Statement on Form SB-2, file no. 333-5098-NY, Post-Effective Amendment No. 2, or (iv) such other documents as the Company has filed with the Securities and Exchange Commission. Pursuant to 17 C.F.R. 230.411, each exhibit filed by the Company is incorporated by reference herein.

3.1	Certificate of Incorporation of the Company
3.2	Amendment to Certificate of Incorporation of the Company, filed in June
3.4	By-Laws of the Company
3.6	Certificate of Incorporation of Breaking Waves, Inc.
3.7	By-Laws of Breaking Waves, Inc.
3.8	Certificate of Amendment to Certificate of Incorporation
4.1	Specimen Common Stock Certificate
4.2	Specimen Warrant Certificate
4.4	Form of Warrant Agreement between the Company, the Underwriter and Transfer & Trust Company
4.5	Form of Restricted Stock Agreement
10.2	The Company's Senior Management Incentive Plan
10.4	Consulting Agreement between Breaking Waves, Inc. and Dan Stone
10.5	Lease for premises at 112 West 34th Street, New York, New York
10.6	Lease for premises at 8410 N.W. 53rd Terrace, Miami, Florida
10.6(a)	Amendment to lease at 8410 N.W. 53rd Terrace, Miami, Florida
10.7	Stock Purchase Agreement between the Company, European Ventures Corp Inc., and the shareholders of Breaking Waves, Inc., dated May, 1996
10.9	Property Acquisition Agreement between the Company and Rogue Features, 1996
10.10	Co-production agreement between the Company and Rogue Features, Inc., and all amendments thereto
10.11	Right of First Refusal Agreement with principals of Rogue Features, Inc.

10.13	Shippers Agency Agreement between Hollywood Productions, Inc., Enterprises, Inc.
10.14	License Agreement between Breaking Waves, Inc. and Beach Patrol, Inc.
10.16	Employment Agreement with Michael Friedland (incorporated by referen exhibit in the Company's 10-KSB for the year ended December 31, 1996)
10.17	Employment Agreement with Malcolm Becker (incorporated by referenc exhibit in the Company's 10-KSB for the year ended December 31, 1996)
10.18	Termination of Employment Agreement with Robert Melillo (incorporated by reference to the indicated exhibit in the Company's 10-KSB for the year ended December 31, 1996)
10.19	Trident Releasing, Inc. License Agreement (incorporated by referen exhibit in the Post-Effective Amendment No. 1)
10.20	Cyclone Option Agreement (incorporated by reference to the indica Post-Effective Amendment No. 1)
10.21	Cyclone Co-Writer Agreement (incorporated by reference to the indica Post-Effective Amendment No.)
10.22	Heller Financial Agreement (incorporated by reference to the indica Post-Effective Amendment No. 2)
10.23	Non-Executive Director Stock Option Plan (incorporated by reference t Proxy Statement for the Company's June 1997 Annual Meeting)
10.24	Kawasaki Motors Corp., USA "Jet Ski" License Agreement (incorporated indicated exhibit in the Company's 10-KSB for the year ended December 31
10.25	Amendment to lease at 112 West 34th Street, New York, New York (incorporated by reference to the indicated exhibit in the Company's 10-KSB for the year ended December 31, 1997)
10.26	Form of Subscription Agreement used in connection with the Company's Fe Placement (incorporated by reference to the indicated exhibit in the Company's 10-KSB for the year ended December 31, 1997)
10.27	Form of Subscription Agreement used in connection with the Company Placement (incorporated by reference to the indicated exhibit in the Company's 10-KSB for the year ended December 31, 1998)
10.28	Amendment to Employment Agreement with Michael Friedland dated (incorporated by reference to the indicated exhibit in the Company's ended December 31, 1998)
10.29	Amendment to Employment Agreement with Malcolm Becker dated January 1, by reference to the indicated exhibit in the Company's 10-KSB for the 31, 1998)
10.30	Second Amendment to Employment Agreement with Malcolm Becker dat (incorporated by reference to the indicated exhibit in the Company's ended December 31, 1998)
10.31	Lease for premises at 14 East 60th Street, Room 402, New York, New York reference to the indicated exhibit in the Company's 10-QSB for the qua 1999)
10.32	Option Agreement - Robb Peck McCooey Clearing Corporation (incorporated by reference to the indicated exhibit in the Company's 10-QSB for the quarter ended September 30, 1999)
10.33	License Agreement with Gottex Models Ltd, dated November 1, 2000
10.34	Factoring Agreement with Century Business Credit Corp. dated September 1
10.35	Supplement to factoring or Security Agreement with Century Business C dated August 14, 2000
10.36	Corporate Guaranty unlimited between Century Business Credit Corpo dated August 14, 2000
10.37	Trademark Collateral Security Agreement between Century Business Cred Breaking Waves, dated August 14, 2000.
10.38	Consulting Agreement with Larry Nash, Inc., dated August 5, 2000

10.39*	Lease between 112 West 34th Street Company, as landlord, and Breakin tenant, dated August 8, 2001.
16.1	Letter from Scarano & Tomaro, P.C. regarding dismissal of Scarano & T Company's auditors (incorporated by reference to the indicated exhib Form 8-K/A filed on November 24, 1998)
21.1	Subsidiaries of the Registrant

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the Undersigned hereunto duly authorized on the 12th day of October, 2001.

ShopNet.Com, Inc.

By: /s/ Harold Rashbaum

Harold Rashbaum
Chairman of the Board, Chief Executive
Officer and President

Pursuant to the requirements of the Securities Act of 1933 as amended, this Registration Statement has been signed below by the following persons in the capacities and on the dates indicated.

/s/ Harold Rashbaum Harold Rashbaum	Chairman of the Board, Chief Executive Officer, President, and Director	10/12/01 Date
/s/ Jeanne Falleta Jeanne Falletta	Secretary and Director,	10/12/01 Date
/s/ Alain Le Guillou, MD Alain Le Guillou, M.D.	Director	10/15/01 Date
/s/ James B. Frakes James B. Frakes	Director	10/15/01 Date
/s/ Michael Friedland Michael Friedland	Director	10/12/01 Date
/s/ Debra Riggs Debra Riggs	Director	10/12/01 Date

SHOPNET. COM, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000

AND

FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

SHOPNET.COM, INC. AND SUBSIDIARIES
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of
Shopnet.com, Inc.

We have audited the accompanying consolidated balance sheet of Shopnet.com, Inc. and subsidiaries (the "Company"), as of June 30, 2001 and December 31, 2000, and the related consolidated statements of operations, stockholders' equity and cash flows for the six months ended June 30, 2001 and for the years ended December 31, 2000 and 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of June 30, 2001 and December 31, 2000 and the consolidated results of its operations and cash flows for the six months ended June 30, 2001 and for the years ended December 31, 2000 and 1999 in conformity with accounting principles generally accepted in the United States of America.

Massella, Tomaro & Co., LLP
Jericho, New York
July 31, 2001, except for Notes 14 and 16, as to which the date is
September 15, 2001

INDEPENDENT ACCOUNTANTS' REPORT

To the Board of Directors and Stockholders of
Shopnet.com, Inc.

We have reviewed the accompanying consolidated statements of income and cash flows of Shopnet.com, Inc. and subsidiaries (the "Company"), for the six months ended June 30, 2000 in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these consolidated financial statements is the representation of the management of the Company.

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the consolidated financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

Massella, Tomaro & Co., LLP
Jericho, New York
August 10, 2000

F - 2

SHOPNET.COM, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
JUNE 30, 2001 AND DECEMBER 31, 2000

ASSETS

	June 30, 2
Current assets:	
Cash	$ 24
Cash - restricted	969
Accounts receivable, net	77
Other receivables	62
Inventory	796
Prepaid expenses	70
Advances to officer	40
Total current assets	2,042
Furniture, computer equipment, and leasehold improvements, net	72
Film production and distribution costs, net	1,204
Costs in excess of net assets of business acquired	727
Investments in movie ventures	246
Deferred tax asset - non-current	202
Other assets	20
Marketable securities - affiliate	6
Total assets	$ 4,522

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Due to factor	$ 1,700
Accounts payable	138
Accrued expenses	21
Capital lease obligations	17
Other taxes payable	
Deferred tax liability	3
Total current liabilities	1,882

Capital lease obligations, net of current portion	3
Total liabilities	1,886
Commitments and contingencies (Note 12)	
Stockholders' equity:	
Common stock - $.001 par value, 20,000,000 shares authorized, 7,472,244 shares issued, outstanding and subscribed	7
Additional paid-in capital	6,638
Accumulated deficit (3,497,510)	(4,01
Accumulated other comprehensive income	6
Total stockholders' equity	2,635
Total liabilities and stockholders' equity	$ 4,522

See accompanying notes to consolidated financial statements

F - 3

SHOPNET.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000

	20
Net sales	$
Cost of sales	
Gross profit	
Expenses:	
Selling, general, and administrative expenses	
Amortization of costs in excess of net assets of business acquired	
Total expenses	
(Loss) income before other income (expense) and provision for income taxes	
Other income (expense):	

Equity in earnings (loss) of affiliate	
Write down of film costs	
Rental and other income	
Interest and finance expense	
Interest income	
Total other income (expense)	
Loss before (benefit of) provision for income taxes	
(Benefit of) provision for income taxes	
Net loss	
Other items of comprehensive (loss) income	
Comprehensive net (loss) income	$
Basic and diluted loss per share:	$
Weighted average number of common shares outstanding - basic and diluted	

See accompanying notes to consolidated financial statements

SHOPNET.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

	20
Net sales	$
Cost of sales	
Gross profit	
Expenses:	
Selling, general, and administrative expenses	
Amortization of costs in excess of net assets of business acquired	
Total expenses	

Loss before other income (expense) and provision for income taxes	
Other income (expense):	
Equity in earnings (loss) of affiliate	
Write down of film costs	
Gain on sale of equity investment in affiliate	
Rental and other income	
Interest and finance expense	
Interest income	
Total other income (expense)	
Loss before (benefit of) provision for income taxes	
(Benefit of) provision for income taxes	
Net loss	
Other items of comprehensive income	
Comprehensive net loss	$
Basic and diluted loss per share:	$
Weighted average number of common shares outstanding	

See accompanying notes to consolidated financial statements

F - 5

SHOPNET.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accu O Compr In
Balances at December 31, 1998 ..	2,686,944	$ 2,687	$ 6,310,103	$ (614,455)	$
Issuance of common stock in connection with January 1999 stock dividend	2,686,944	2,687	(2,687)	--	

Stock issued for compensation in accordance with employment agreements	215,732	216	38,420	--	
Net loss for the year ended December 31, 1999	--	--	--	(1,976,079)	
Balances at December 31, 1999 ..	5,589,620	5,590	6,345,836	(2,590,534)	
Issuance of common stock in connection with January 2000 stock dividend	537,389	537	(537)	--	
Sale of common stock in February 2000, net of costs	100,000	100	294,798	--	
Issuance of common stock in connection with May 2000 stock dividend	1,245,235	1,245	(1,245)	--	
Unrealized gain on mark to market securities	--	--	--	--	
Net loss for the year ended December 31, 2000	--	--	--	(906,976)	
Balances at December 31, 2000 .. (carried forward)	7,472,244	7,472	6,638,852	(3,497,510)	

See accompanying notes to consolidated financial statements

SHOPNET.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

	Common Stock		Additional		Ac
	Shares	Amount	Paid-in Capital	Accumulated Deficit	Com
Balances at December 31, 2000 (From previous page)	7,472,244	7,472	6,638,852	(3,497,510)	
Unrealized loss on securities ...	--	--	--	--	(
Net loss for the six months ended June 30, 2001	--	--	--	(519,669)	
Balances at June 30, 2001	7,472,244	$ 7,472	$ 6,638,852	$(4,017,179)	$

See accompanying notes to consolidated financial statements

SHOPNET.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000

Cash flows from operating activities:	
Net loss	$ (519
Adjustments to reconcile net loss to net cash (used for) provided by operating activities:	
Equity in earnings (loss) of affiliate	2
Amortization and depreciation	49
Deferred income tax (benefit) expense	(1
Write down of film costs	145
Decrease (increase) in:	
Accounts receivable	(29
Other receivables	(34
Inventory	2,667
Prepaid expenses	36
Other assets	
Increase (decrease) in:	
Due to factor	(1,465
Accounts payable	(957
Accrued expenses	(77
Other taxes payable	(10
Net cash (used for) provided by operating activities	(194
Cash flows from investing activities:	
Acquisition of furniture, computer equipment, and leasehold improvements	(24
Loan repayments to affiliate	
Investment in movie ventures	(1
Net cash used in investing activities	(25
Cash flows from financing activities:	
Proceeds from sale of common stock	
Proceeds from line of credit	
Repayments of line of credit	
Principal payments on capital lease obligations	(8
Net cash (used in) provided by financing activities	(8
Net (decrease) increase in cash	(228
Cash, beginning of period	1,222
Cash, end of period	$ 994

See accompanying notes to consolidated financial statements

F - 8

SHOPNET.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000

	2001
Supplemental disclosure of non-cash flow information:	
Cash paid during the year for:	
Interest	$ 300,2
Income taxes	$

See accompanying notes to consolidated financial statements

F - 9

SHOPNET.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

Cash flows from operating activities:	
Net loss	$ (906
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:	
Equity in earnings (loss) of affiliate	4
Amortization and depreciation	117
Deferred income tax (benefit) expense	(10
Write down of film costs	308
Stock issued for services rendered	
Decrease (increase) in:	
Accounts receivable	(16
Other receivables	(27
Inventory	(602
Prepaid expenses	(36
Film production and distribution costs	
Increase (decrease) in:	
Due to factor	1,389
Accounts payable	(33
Accrued expenses	40
Other taxes payable	11

Net cash provided by (used for) operating activities	236
Cash flows from investing activities:	
Proceeds from sale of equity investment in affiliate	
Acquisition of furniture, computer equipment, and leasehold improvements	(15
Acquisition costs	
Investment in movie ventures	(5
Net cash (used for) provided by investing activities	(20
Cash flows from financing activities:	
Proceeds from sale of common stock	294
Proceeds from line of credit	250
Repayments of line of credit	(250
Advances from related parties	
Repayments to related parties	(650
Principal payments on capital lease obligations	(15
Net cash (used for) provided by financing activities	(370
Net (decrease) increase in cash	(153
Cash, beginning of period	1,376
Cash, end of period	$ 1,222

See accompanying notes to consolidated financial statements

F -10

SHOPNET.COM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

	2000
Supplemental disclosure of non-cash flow information:	
Cash paid during the year for:	
Interest	$ 379,8
Income taxes	$

In connection with the issuance of compensation, 215,732 shares of common stock were issued	$
	===============

See accompanying notes to consolidated financial statements

SHOPNET.COM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

NOTE 1 - ORGANIZATION

Shopnet.com, Inc. ("Shopnet") 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, it 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 - SUMMARY OF SIGNIFICANT 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) Cash and cash equivalents

The Company considers highly liquid investments with maturities of three months or less at the time of purchase to be cash and cash equivalents. Included in these amounts are certificates of deposit of approximately $750,000. The Company maintains balances in accounts which are in excess of Federal Deposit Insurance Corporation limits by approximately $665,000. The Company believes that such risk is minimal based on the reputation of the financial institution. At June 30, 2001 the Company has classified $969,582 as restricted cash which is comprised of approximately $750,200 on deposit with a bank and $219,400 with its factor as collateral pursuant to its factoring agreement.

c) Accounts receivables

The Company utilizes the allowance method for recognizing the collectibility of its accounts receivables. The allowance method recognizes bad debt expense based on a review of the individual accounts outstanding based on the surrounding facts. As of June 30, 2001 and December 31, 2000, no allowance was deemed necessary by management.

NOTE 2 -SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

d) Marketable securities

All the Company's marketable securities are classified as available for sale and recorded at current market value. Net unrealized gains and losses on marketable securities available for sale are credited or charged to other comprehensive income. Marketable securities were classified as non-current as a result of being pledged pursuant to the factoring agreements.

e) 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.

f) Furniture, computer equipment, and leasehold improvements

Furniture, computer equipment, and leasehold improvements are recorded at cost less accumulated depreciation and amortization which is provided on the straight line basis over the estimated useful lives of the assets which range between five and seven years. Expenditures for maintenance and repairs are expensed as incurred.

g) 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 revenues can change significantly due to the level of market acceptance of film products. Accordingly, revenue estimates are reviewed periodically and amortization is 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.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

g) Film production and distribution costs (cont'd)

For the six months ended June 30, 2001 and 2000 and for the years ended December 31, 2000 and 1999, the Company has written down film production and distribution costs by $145,272, $100,000, $308,564 and $261,153, respectively, in order to reduce the balance to its estimated net realizable value.

h) Intangible assets

At each balance sheet date, the Company evaluates the period of amortization of intangible assets. The factors used in evaluating the period of amortization include: (i) current operating results, (ii) projected future operating results, and (iii) other material factors that affect the continuity of the business.

i) 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.

j) Income taxes

The Company accounts for income taxes in accordance with the "liability method" of accounting for income taxes. Accordingly, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases 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.

k) 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.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

k) Revenue and cost recognition (cont'd)

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.

l) 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 shareholders 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.

m) Use of estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions 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.

n) Fair value disclosure at June 30, 2001 and December 31, 2000

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

o) Reclassifications

Certain prior period accounts have been reclassified to conform to the current year presentation.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

p) Costs in excess of net assets of business acquired

Costs in excess of net assets of business acquired in connection with the acquisition of Breaking Waves are being amortized on a straight line basis over the estimated useful life of the related assets acquired for a period of fifteen years.

q) Accounting for stock-based compensation

The Company elected to continue to measure compensation cost using Accounting Principles Board Opinion ("APB") No. 25,"Accounting for Stock Issued to Employees," as is permitted by SFAS No. 123, "Accounting for Stock-Based Compensation."

Accordingly, no compensation cost has been recognized for the options issued under the Incentive Plan as the exercise price and market value at the date of grant were the same.

For companies that choose to continue applying APB No. 25, SFAS No. 123 requires certain pro forma disclosures as if the fair value method had been utilized. Had compensation cost for the Company's stock-based compensation plan been determined based on the fair value at the grant dates for awards under the plan consistent with the method of SFAS No. 123, the Company's net income (loss) and earnings per share would have been reduced to the pro forma amounts indicated below utilizing the Black-Sholes option pricing model:

	June 30, 2001	June 30, 2000 (unaudited)	
Net income (loss)-			
as reported	$ (519,669)	$ (203,446)	$
pro forma	$ (519,669)	$ (203,446)	$
Basic and Diluted EPS -			
as reported	$ (.07)	$ (.03)	$
pro forma	$ (.07)	$ (.03)	$

SHOPNET.COM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

q) Accounting for stock-based compensation (cont'd)

The fair market value of each option grant is estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

Dividend yield	0.00%
Expected volatility	30%
Risk-free interest rate	6%
Expected life	1-5 years

r) Effect of new accounting standards

The Company does not believe that any recently issued accounting standards, not yet adopted by the Company, will have a material impact on its financial position and results of operations when adopted.

NOTE 3 - FURNITURE, COMPUTER EQUIPMENT & LEASEHOLD IMPROVEMENTS

Furniture, computer equipment, and leasehold improvements are as follows:

	June 30, 2001
Furniture & fixtures	$ 38,727
Computer equipment and software	104,070
Leasehold improvements	13,415
	156,212
Less: accumulated depreciation and amortization	84,075
	$ 72,137

Computer equipment and software amounting to $61,506 is pledged in connection with capital lease obligations.

Depreciation and amortization expense for the six months ended June 30, 2001 and 2000 and for the years ended December 31, 2000 and 1999 amounted to $13,997, $21,876, $21,376 and $19,023, respectively.

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 is being amortized over the useful lives of the related assets which is fifteen years. Amortization expense totaled $35,476 for each of the six months ended June 30, 2001 and 2000 and $70,952 for each of the years ended December 31, 2000 and 1999, respectively.

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 June 30, 2001 and December 31, 2000 $217,500 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.

The Company accounts for the investment in Battle Studies under the equity method. For the six months ended June 30, 2001 and 2000 and for the years ended December 31, 2000 and 1999, the Company recorded $1,473, $-0-, $4,290 and $-0-, respectively, equity losses for its proportionate share of Battle Studies. No revenues have been derived from this film as of June 30, 2001 and December 31, 2000.

On October 12, 2000, Battle Studies entered into a distribution agreement with Raven Pictures International ("Raven Pictures") to distribute Battle Studies motion picture ("Machiavelli 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 expenses.

On January 17, 2001, Battle Studies entered into a distribution agreement with KOAN, Inc. ("KOAN") to distribute and promote Battle Studies' motion pictures ("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.

NOTE 5 - INVESTMENTS IN MOVIE VENTURES (cont'd)

b) The Girl

Pursuant to an agreement dated July 1, 1999 with Artistic License Films Inc., Hollywood invested through June 30, 2001 and December 31, 2000 $35,000 for a 22.533% interest in a new entity, The Girl, LLC a limited liability company ("The Girl"). 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.

Hollywood accounts for the investment in The Girl under the equity method. During the six months ended June 30, 2001, The Girl began to generate revenues resulting in a net equity loss to the Company of $1,298, resulting in an investment balance of $33,702 as of June 30, 2001.

NOTE 6 - MARKETABLE SECURITIES - AFFILIATE

On November 24, 1998, pursuant to a sales agreement entered into during September 1998 by and between Breaking Waves and 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 the Company), Breaking Waves purchased 1,400,000 unregistered shares of Play Co.'s common stock for a total of $504,000 comprised of $300,000 in cash and by shipping $204,000 of merchandise to Play Co. After the purchase, Breaking Waves owned 25.4% of the outstanding common stock of Play Co.

Breaking Waves accounted for its investment under the equity method. For the year ended December 31, 1999 Breaking Waves recorded $994,305 of equity loss for its proportionate share of Play Co's loss for that year.

As of December 31, 1999, the Company's investment in Play Co. was reduced to $-0- since its share of Play Co.'s losses exceeded its cost basis. In addition, as of December 31, 1999, as a result of Play Co.'s issuance of additional common stock and the Company's sale of 130,000 shares of Play Co.'s common stock, the Company's percentage ownership was reduced to 22.88%.

NOTE 6 - MARKETABLE SECURITIES - AFFILIATE (cont'd)

During the year ended December 31, 2000, Play Co. converted a portion of its series E preferred stock into common stock, thereby reducing Breaking Waves' ownership percentage to approximately 1.5%. Accordingly, upon this event the accounting method for the investment in Play Co. was changed to 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 June 30, 2001 and December 31, 2000 which amounted to $6,350 and $107,950, respectively. The change in unrealized gain or loss has been recorded 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 entering into a new factoring agreement with Century Business Credit Corporation ("Century") and are therefore considered non-current (See Note 8 (b)).

On March 28, 2001, Play Co. filed for protection under Title Eleven of the United States Code with the United State Bankruptcy Court for the Southern District of New York. The filing was converted into a Title Seven filing on August 28, 2001. The Company is in the process of developing a plan for the orderly liquidation of the Company's operations through discussions with representatives of its secured lender, other creditors, landlords and others under the supervision of the Bankruptcy Court.

NOTE 7 - ACCRUED EXPENSES

Accrued expenses consist of the following:

	June 30, 2001
Commissions	$ -
Professional fees	18,827
Other corporate overhead	3,138
	$ 21,965

NOTE 8 - 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.

SHOPNET.COM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

NOTE 8 - DUE TO FACTOR (cont'd)

a) CIT Group (cont'd)

Breaking Waves took advances of up to 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 the year ended December 31, 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. As of June 30, 2001 and December 31, 2000, a balance of $-0- and $312 was due CIT, respectively. Interest expense related to this agreement totaled $204,821 and $228,772 for the years ended December 31, 2000 and 1999.

b) Century Business Credit Corporation

On or about September 12, 2000, Breaking Waves entered into a factoring and revolving inventory loan and security agreement with Century to sell their 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 continue maintaining $1,150,000 of cash in a 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 its investment in Play Co., which is represented by 1,270,000 shares of Play Co's common stock.

Pursuant to the terms of a Reimbursement and Compensation Agreement (the "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 the collateral 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. See Note 16.

NOTE 8 - DUE TO FACTOR (cont'd)

b) Century Business Credit Corporation (cont'd)

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 December 20, 2000, Breaking Waves paid a fee of $42,500 to the Trust and reimbursed the Trust for all related professional and other fees incurred by the Trust in connection with such transaction.

On May 3, 2001, the Agreement 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. See Note 16.

Interest expense related to the factor agreement totaled $256,429 for the six months ended June 30, 2001 and $100,488 for the year ended December 31, 2000. Century has a secured interest in Breaking Waves' inventory as collateral for the advances. As of June 30, 2001 and December 31, 2000 the net advances to Breaking Waves from Century amounted to $1,700,337 and $3,165,597, respectively.

NOTE 9 - LINE OF CREDIT

On March 30, 2000, the Company entered into a revolving line of credit agreement with a bank. Total available credit under the line of credit is $250,000. Total outstanding balance was payable in monthly installments including 9% interest. As a condition of the line of credit, the Company was required to deposit $250,000 in a certificate of deposit as collateral with the bank. The line of credit was repaid in full and closed as of July 12, 2000.

NOTE 10 - CAPITAL LEASE OBLIGATIONS

During the year ended December 31, 1998, the Company acquired computer equipment and proprietary software for its subsidiary, Breaking Waves, pursuant to the following terms and conditions:

i) The Company acquired various computer and related components for $28,583 by entering into a capital lease obligation with interest at approximately 9.2% per annum, requiring 48 monthly payments of principal and interest of $762. The lease is secured by the related computer equipment.

F - 22

SHOPNET.COM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

NOTE 10 - CAPITAL LEASE OBLIGATIONS (cont'd)

ii) The Company acquired proprietary software for $32,923 by entering into a capital lease obligation with interest at approximately 10.9% per annum, requiring 48 monthly payments of principal and interest of $850. The lease is secured by the related software.

At June 30, 2001, the aggregate future minimum lease payments due pursuant to the above capital lease obligations are as follows:

	Year e Ju
2002	$
2003	
Total minimal lease payments	
Less: Amounting representing interest	
Present value of net minimum lease payments	$

At June 30, 2001 and December 31, 2000 equipment and software under capital leases is carried at a book value of $24,606 and $30,750, respectively.

NOTE 11 - (BENEFIT OF) PROVISION FOR INCOME TAXES

(Benefit of) provision for income taxes is comprised of the following:

	June 30, 2001	June 30, (unaudited) 2000	200
Current:			
Federal	$ -	$ -	$
State and local	642	10,970	
	642	10,970	
Deferred:			
Federal	-	-	
State and local	(1,098)	-	
	(1,098)	-	(
Total (benefit of) provision for income taxes	$ (456)	$ 10,970	$

SHOPNET.COM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

NOTE 11 - (BENEFIT OF) PROVISION FOR INCOME TAXES (cont'd)

A reconciliation of the provision for income taxes on income per the federal statutory rate to the reported income tax expense is as follows:

	June 30, 2001	June 30, (unaudite 2000
Federal statutory rate applied to pretax loss	$ -	$ -
State and local income taxes, net of federal income tax benefit, applied to pretax loss	-	-
Permanent differences	-	-

Increase in valuation allowance	-	-
Current provision for state and local taxes	642	10,970
(Increase) in deferred tax assets	-	-
Increase (decrease) in deferred tax liability	(1,098)	-
Total provision (benefit) for income taxes	$ (456)	$ 10,970

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related to difference between the financial statement and income tax bases of assets and liabilities for financial statements and income tax reporting purposes. Deferred tax assets and liabilities represent the future tax return consequences of these temporary differences, which will either be taxable or deductible in the year when the assets or liabilities are recovered or settled. Accordingly, measurement of the deferred tax assets and liabilities attributable to the book-tax basis differential are computed at a rate of 34% federal and 11% state and local pursuant to SFAS No. 109.

The tax effect of significant items comprising the Company's net non-current deferred tax assets and liability are as follows:

	June 30, 2001
Net operating loss carryforwards	$ 1,167,919
Inventory capitalization	166,995
Write down of film costs	392,380
Valuation allowance	(1,524,794)
Deferred non-current tax asset	202,500
Equity earnings of affiliate	2,858
Depreciable assets	748
Deferred non-current tax liability	3,606
Net non-current deferred tax asset	$ 198,894

SHOPNET.COM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

NOTE 11 - (BENEFIT OF) PROVISION FOR INCOME TAXES (cont'd)

Shopnet and its subsidiaries have a tax year end of December 31 and file a consolidated tax return for federal tax purposes. For state and local purposes, Shopnet and its subsidiaries file separate tax returns. As such, each entity computes its state and local tax based on it own taxable income or loss.

At June 30, 2001 and December 31, 2000, the Company had a net operating loss carryforward (NOL) of approximately $2,072,000 for federal tax purposes and $2,172,000 for state tax purposes, all of which expire between 2010 and 2020. Management believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

a) Lease commitments

Shopnet and Breaking Waves have entered into lease agreements for their administrative offices. Shopnet leases its administrative office pursuant to a 5-year lease expiring November 30, 2001 at annual rent amounting to approximately $70,000, before annual escalations. Breaking Waves leased its administrative offices pursuant to a lease requiring annual payments of $71,600 expiring December 2004. Lastly, Breaking Waves terminated its lease effective November 30, 2001. A new 6 year lease expiring September 30, 2007 was signed 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. 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 June 30, 2001 (including Breaking Waves' new lease) are as follows:

2002	$ 111,8
2003	84,9
2004	84,9
2005	90,3
2006	95,7
Thereafter	119,7
	$ 587,4

Rent expense for the six months ended June 30, 2001 and 2000 and for the years ended December 31, 2000 and 1999 amounted to approximately $83,500, $79,500, $163,900 and $172,700, respectively.

SHOPNET.COM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

NOTE 12 - COMMITMENTS AND CONTINGENCIES (cont'd)

b) Significant vendors and customers

Breaking Waves purchases 100% of its inventory from two vendors, one in Indonesia and the other from Samoa. Breaking Waves believes other sources and vendors are available and that it is not dependent exclusively on these vendors. For the six months ended June 30, 2001 and 2000 and for the years ended December 31, 2000 and 1999, Breaking Waves had two, two, three and four customers, respectively, which comprised 37%, 54%, 46% and 52%, of net sales, respectively.

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.

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 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 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 effective July 1, 2001 calls for minimum annual royalties of $50,000 to $87,500 over the life of the extension with options 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 $150,000, $99,113, $163,009 and $162,501 during the six months ended June 30, 2001 and 2000 and during the years ended December 31, 2000 and 1999, respectively.

ii) On October 31, 1996, Breaking Waves entered into a license agreement with North-South Books, Inc. ("N-S") for the exclusive use of certain art work and text in the making of swimsuits and accessories in the United States and Canada. The agreement expired on March 1, 1999. Breaking Waves recorded $-0- and $784 of royalties under this agreement during the years ended December 31, 2000 and 1999, respectively.

NOTE 12 - COMMITMENTS AND CONTINGENCIES (cont'd)

d) License agreements (cont'd)

iii) On October 17, 1997, Breaking Waves entered into a license agreement with Kawasaki Motors Corp., U.S.A. ("KMC") with an effective date of July 1, 1997 for the exclusive use of certain trademarks in the making of swimwear in the United States. The fee for the exclusive use of certain trademarks is five percent (5%) of net sales. The agreement expired on May 31, 1999 and was not renewed. Breaking Waves recorded royalties under this agreement totaling $-0- and $10,415 during the years ended December 31, 2000 and 1999, respectively.

iv) During June 2000, Breaking Waves entered into a license agreement with an effective date of November 1, 2000 with Gottex Models Ltd., an 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 $26,610 and $8,859 for the six months ended June 30, 2001 and for the year ended December 31, 2000, 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-producer agreeing to finance $100,000 of the costs 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 June 30, 2001 and December 31, 2000, the Company invested

$1,971,956 for the co-production and distribution of such motion picture whereas the co-producers have invested $100,000. For the six months ended June 30, 2001 and 2000 and for the years ended December 31, 2000 and 1999, the Company derived no revenues from the motion picture and amortized no film costs.

For the six months ended June 30, 2001 and 2000 and for the year ended December 31, 2000 and 1999, the Company has written down its film production and distribution costs by $145,272, $100,000, $308,564 and $261,153, respectively, in order to reduce the asset to its estimated net realizable value.

NOTE 12 - COMMITMENTS AND CONTINGENCIES (cont'd)

f) Employment agreements

On November 27, 1996, Breaking Waves entered into two employment agreements (as amended) with two key employees. Such employees are responsible for the designing, marketing and sales of Breaking Waves. The employment agreements are for a term of three years with annual salaries of $110,000 each for 1997 and $60,000 and $130,000 for 1998 (as amended), respectively.

One of the employment agreements was further amended effective January 1, 1999 with an annual salary increase from $60,000 to $70,000. In connection with the decrease in salary from originally $110,000 per year to $70,000 per year for one of the key employees, the Company reduced the value of shares to be issued to $13,636 for 1998. As of June 30, 2001, the employees are still employed and all prior arrangements are in effect.

Effective July 2001, Breaking Waves and the employees agreed to decrease the annual salaries from $130,000 to $105,000 and $70,000 to $50,000, respectively.

g) Litigation

On or about June 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 disallowing the exercise of these options). The plaintiff seeks, among other things, compensatory damages in the amount of $497,500 and punitive damages in the amount of $995,000, together with costs and attorney's fees. The Company has responded to the complaint and denied the allegations. The Company intends to contest the action vigorously and believes that such claims against it are baseless and without merit.

NOTE 13 - STOCKHOLDERS' EQUITY

a) Stock Dividends

i) On January 14, 1999, the Company declared a 100% stock dividend to all shareholders of record as of January 29, 1999 amounting to a total of 2,686,944 shares of common stock. The stock dividend was issued on February 5, 1999. In order for shareholders to receive their stock dividend, they must exchange the old shares for the new shares.

As a result of such stock dividend, the Company issued 2,686,027 shares of its common stock. An additional 917 shares are entitled to the dividend, and such shares shall be issued to the holders upon the redemption of the old shares. After the effect of stock dividends these shares are 2,420 at June 30, 2001 and December 31, 2000.

NOTE 13 - STOCKHOLDERS' EQUITY (cont'd)

a) Stock Dividends (cont'd)

ii) On January 7, 2000, the Company declared a 10% stock dividend to all shareholders of record as of January 20, 2000 amounting to 537,389 shares of common stock. Such stock dividend was issued on February 1, 2000.

iii) On May 8, 2000, the Company declared a 20% stock dividend to all shareholders of record as of May 19, 2000 amounting to 1,245,235 shares of common stock. Such stock dividend was distributed on June 19, 2000.

b) Sale of common stock

On February 1, 2000, the Company sold 100,000 shares of common stock for $300,000 (before certain transaction costs) pursuant to a private transaction with an unrelated party. Giving effect to the May 2000 20% stock dividend the related shares are 120,000.

c) 1996 Senior Management Incentive Plan

The shareholders approved the 1996 Senior Management Incentive Plan ("Incentive Plan") in May 1996. Officers, key employees and non-employees, who in the judgment of the Company render significant service to the Company, are eligible to participate.

The Incentive Plan provides for the award of a broad variety of stock-based compensation alternatives such as non-qualified stock options, incentive stock options, restricted stock, performance awards and stock appreciation rights. The Incentive Plan provided 750,000 shares of common stock to be offered from either authorized and unissued shares or issued shares, which have been reacquired by the Company.

On March 14, 1997, the Company granted 132,000 options to purchase shares of common stock pursuant to the Company's Incentive Plan consisting of 88,000 options to the Company's President and 44,000 options to another officer. The exercise price of each option was fixed at $1.46 (as revised) per share and the options expire March 2002. The terms of the options state that in the event of termination of optionee's employment the vested portion of the options shall remain exercisable for six months after termination, at which time the options expire.

The officer granted the 44,000 options has resigned as an officer of the Company and is currently performing consulting services for the Company. Based on the terms of the option agreement his options should have terminated. The Company has agreed to extend the expiration date of such options to December 2001.

NOTE 13 - STOCKHOLDERS' EQUITY (cont'd)

c) 1996 Senior Management Incentive Plan

During April 1999, the Company granted its President 44,000 stock options. The exercise price of each option is a $1.38 per share and the options expire April 16, 2004.

A summary of the status of the Company's stock options outstanding as of December 31, 2000 and changes during the six months ended June 30, 2001 and during the years ended December 31, 2000 and 1999 are as follows:

	Number of Options	Exercise Price
Outstanding at December 31, 1998	132,000	1.46
Granted	44,000	1.38
Exercised	--	--
Cancelled	--	--
Outstanding at December 31, 1999	176,000	1.46 - 1.38
Granted	--	--
Exercised	--	--

Cancelled	--	--
Outstanding at December 31, 2000	176,000	$1.46 - 1.38
Granted	--	--
Exercised	--	--
Cancelled	--	--
Outstanding at June 30, 2001 ...	176,000	$1.46- 1.38

d) 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 eighteen 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 effected 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, January 2000 10% common stock dividend and 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.

NOTE 13 - STOCKHOLDERS' EQUITY (cont'd)

d) Warrants (cont'd)

ii) On April 15, 1998, the Company's Board of Directors authorized the distribution of warrants to all holders of shares of the Company's common stock as of May 8, 1998. Pursuant to the distribution, each shareholder of record received 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, shall be issued and distributed once the Company has filed 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.

e) Grant of Stock Options

In connection with a consulting and option agreement entered on September 1, 1999, the Company granted 400,000 options to purchase shares of the Company as follows; 100,000 shares at an exercise price of $2.50 per share, 100,000 shares at an exercise of $3.00 per share, 100,000 shares at an exercise price of $3.50 per share and 100,000 shares at an exercise price of $4.00 per share. No consulting expenses were recorded in connection with such options based on the underlying value of the stock on the grant date. As of September 2000, the options expired and no options were ever exercised.

NOTE 14 - RELATED PARTIES TRANSACTIONS

a) During November 1998, the Company agreed to issue 215,732 shares of common stock in the amount equal to the fair market value of $38,636, to two key employees of Breaking Waves in connection with their employment agreements. The shares vested in November 1999 and the Company recorded compensation expense amounting to $38,636 during the year ended December 31, 1999. The employees agreed to postpone the issuance of such shares of common stock as follows fifty percent of the shares in May 2000 and fifty percent of the shares in November 2000.

b) For the six months ended June 30, 2001 and 2000 and for the years ended December 31, 2000 and 1999, financial consulting fees were paid to a corporation and an individual who are related to the Company's President and CEO amounting to $24,000, $29,000, $51,080 and $36,000, respectively.

c) 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 June 30, 2001 and December 31, 2000, one Promissory note remains amounting to $37,000 and has been classified as current. As of June 30, 2001 and December 31, 2000, the Company's President and CEO was also advanced additional funds totaling $3,000 which are non-interest bearing and due on demand and are classified as current.

NOTE 14 - RELATED PARTIES TRANSACTIONS (cont'd)

d) During October 1999, Play Co. loaned funds to Breaking Waves in return for an unsecured promissory note in the amount of $200,000. Such note was due and was repaid in full on March 29, 2000 plus interest at 9% per annum.

e) On November 29, 1999, Play Co. loaned additional funds to Breaking Waves in return for an unsecured promissory note in the amount of $400,000. Such note is due in two installments. The first installment of $100,000 was due and repaid January 30, 2000 and the second installment of $300,000 was due and repaid April 30, 2000. Interest accrued at 9% per annum.

f) During October 1999, Play Co. loaned funds to the Shopnet in return for an unsecured promissory note in the amount of $50,000. Such note is due in full and was repaid on March 29, 2000 plus interest at 9% per annum.

g) On December 20, 2000, the Company entered into the Agreement with the Trust, the beneficiary of which is a relative of the Company's President and CEO and a relative of a principal stockholder. The Trust pledged assets as collateral for securing a $250,000 letter of credit to replace a portion of the collateral previously pledged by the Company in connection with its factoring agreement with Century. The Company paid $42,500 to the Trust in connection with the Agreement.

On May 3, 2001, the Agreement 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.

On September 15, 2001, the Agreement was further amended so that the letter of credit secured by the Trust was increased to $750,000. The amended letter of credit expires on September 1, 2001 but can be extended year to year at the Company's option for a period of ten years.

On September 15, 2001, the Company entered into a new 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 in connection with Breaking Waves' factoring agreement with Century. Absent any default, the letter of credit will remain in effect for ten years.

In exchange for the above 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. Upon the signing of the Agreement, 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. See Note 16.

NOTE 15 - INDUSTRY SEGMENTS

The Company's operations have been classified into two segments: swimwear sales and film productions. Information about the two segments is as follows:

	Six months ended Ju		
	2001		
	Segment	Consolidated	Segment
Sales:			
Swimwear sales	$ 4,728,948		$ 3,673,77
Film production	-		
Total sales		$ 4,728,948	
Operating income (loss):			
Swimwear sales		$ 208,902	
Film production		(145,272)	
Total operating income		63,630	
Corporate:			
General and administrative expense		(284,580)	
(Loss) equity in earnings of affiliate		(2,771)	
Amortization expense		(35,476)	
Interest income		24,945	
Interest and finance expense		(300,273)	
Other		14,400	
Loss from operations before (benefit) provision for income tax		(520,125)	
(Benefit) provision for income tax		(456)	
Net (loss) income		$ (519,669)	
Identifiable assets:			
Swimwear sales		$ 1,313,223	
Film productions		1,451,167	
Corporate		1,757,685	
Total assets		$ 4,522,075	

AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

NOTE 15 - INDUSTRY SEGMENTS (cont'd)

	Years ended December 31, 2000 Segment	2000 Consolidated	199 Segment
Sales:			
Swimwear sales	$ 5,713,133		$ 4,756,49
Film production	-		
Total sales		$ 5,713,133	
Operating income (loss):			
Swimwear sales		$ 310,068	
Film production		(314,135)	
Total operating income		(4,067)	
Corporate:			
General and administrative expense		(564,346)	
(Loss) equity in earnings of affiliate		(4,290)	
Gain on sale of equity investment		-	
Amortization expense		(70,952)	
Interest income		80,156	
Interest and finance expense		(371,752)	
Other		22,271	
Loss from operations before (benefit) provision for income tax		(912,980)	
(Benefit) provision for income tax		(6,004)	
Net (loss) income		$ (906,976)	
Identifiable assets:			
Swimwear sales		$ 4,072,174	
Film productions		1,598,210	
Corporate		1,993,411	
Total assets		$ 7,663,795	

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

SHOPNET.COM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
AND FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

NOTE 16 - SUBSEQUENT EVENT

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 September 15, 2001, the Amended and Restated Reimbursement and Compensation Agreement (See Note 8b) was further amended 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 new 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.

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. Upon the signing of the Agreement, 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.

In exchange for facilitating the financing arrangements for both the Amended and Restated Reimbursement and Compensation Agreement and the Reimbursement Agreement dated September 15, 2001, Arc Financial Corp. ("Arc") received a consulting fee of i)$209,500 on September 15, 2001 ($20,000 per year for ten years payable in advance plus costs) and ii) one and one quarter percent (1-1/4%) of net sales of Breaking Waves through June 30, 2002 and one and three quarters (1-3/4%) percent of net sales through September 30, 2011. On September 15, 2001, Arc received advance payments to be applied towards future fees of $36,750. All payments are payable forty five days after the close of each fiscal quarter. The agreement with Arc expires September 30, 2011.