

GAMECOM INC
Form 10KSB40
April 01, 2002

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

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

For the Fiscal Year Ended December 31, 2001

or

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

For the transition period from _____ to _____

Commission File Number 000-28381

GAMECOM, INC.

(Exact name of Registrant as specified in its Charter)

Texas

(State or other jurisdiction of incorporation or organization)

93-1207631

(IRS Employer Identification No.)

440 North Center, Arlington, TX
(Address of principal executive offices)

76011
(Zip Code)

(817) 265-0440

(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE SECURITIES EXCHANGE ACT OF 1934:

None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934:

Common Stock, par value \$.005 per share

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not 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-K or any amendment to this Form 10-K. YES NO

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

The aggregate market value of the voting stock held by non-affiliates of the Registrant at March 26, 2002 was approximately \$4,727,916. The number of shares of Registrant's Common Stock outstanding on December 31, 2001 was 32,931,842. Revenue for the most recent fiscal year was \$2,463,064.

#

Part I

Item 1. Description of Business

BUSINESS OVERVIEW

GameCom, Inc. (the "Company") was organized in 1996 to operate theme concept microbrewery restaurants. In 1997, the Company acquired First Brewery of Dallas, Inc., which operated the former Hubcap Brewery & Kitchen of Dallas, Texas (later renamed The Schooner Brewery(TM) brewpub). As a result of several factors, including relatively strict laws that apply to craft brewers in Texas, GameCom found it difficult to develop this initial business, and closed down its microbrewery operations in early 1999.

In December of 1997, GameCom acquired all rights to 'Net GameLink(TM) , an interactive entertainment system designed to allow a number of players to compete with one another in a game via an intranet or the Internet. From 1999 when it closed its microbrewery operations until it acquired Ferris Productions, Inc. as described below, GameCom had been devoting substantially all of its efforts to implementing the 'Net GameLink(TM) product and its

operations were limited to development, construction and beta-testing of the initial 'Net GameLink(TM) prototype system at J. Gilligan's Bar and Grill in Arlington, Texas.

In February, 2000, the Company changed its jurisdiction of incorporation from Nevada to Texas. The Company maintains its principal office at 440 North Center, Arlington, Texas 76011, and its telephone number is (817) 265-0440.

In September, 2001, the Company completed the acquisition of Ferris Productions, Inc., a leading developer and operator of virtual reality devices. Ferris designs, develops, distributes, and operates technically-advanced products for the entertainment, simulation, promotion, and education markets. The acquisition provided the Company with a wider array of products within the Company's industry, an experienced management team, an existing revenue stream, and established distribution channels. Post-merger, the Company believes it to be the world's largest virtual reality developer and manufacturer.

The Company's virtual reality devices are computer-based, and allow participants to view and manipulate graphical representations of physical reality. Stimulating the senses of sight, sound, touch, and smell simultaneously, the Company's virtual reality devices envelop the participant in dynamic computer-generated imagery, and allow the participant to interact with what he or she sees using simple controls and body motions. Virtual reality products and systems typically employ head-mounted displays that combine high-resolution miniature image source monitors, wide field-of-view optics, and tracking sensors in a unit small and light enough to be worn on the head. These products usually surround the participant with dynamic three-dimensional imagery, allowing the user to change perspective on the artificial scenes by simply moving his or her head. Virtual reality devices have in the past been used primarily in connection with electronic games, as, by surrounding the player with the sights, sounds, and smells he or she would experience in the real world, play is made far more realistic than it would be if merely presented in a two-dimensional flat screen display.

The Company's virtual reality devices within the entertainment/amusement market are designed to produce a highly-realistic experience at a significantly lower cost than traditional virtual reality technology. Historically, the software for virtual reality games and other applications was separately created for each application. The Company makes use of its patented Universe™ Control Board, which, when installed in an ordinary PC, makes it possible to quickly adapt PC games for the arcade market, permitting easy conversion of PC games to behave as coin-operated arcade games, and allows the operator to change from one game to another without expensive hardware replacement.

Within the entertainment/amusement market, the Company has installed and operates virtual reality entertainment centers known as VR Zones in over a dozen theme parks and high-traffic visitor locations such as Six Flags, Paramount Parks, Busch Gardens, Circus Circus, and Carnival Cruise Lines. These VR Zones are equipped with systems developed and manufactured by the Company, and are operated with Company employees on a revenue-share basis with the theme park locations.

The Company entered the advertising/promotion market with its 2000 Ride With Confidence Tour for Buick, featuring a virtual reality test-drive of a Buick LeSabre with PGA professional Ben Crenshaw accompanying the participant. This project led the Company to additional projects within this market, such as a virtual reality bi-plane

experience for Red Baron Pizza, and the recently-completed virtual reality ski jump experience for Chevrolet in conjunction with the Olympic Torch City Celebration Tour.

The Company's anticipated entry into the training/simulation market was advanced by the aftermath of September 11, 2001. The Company remains in advanced discussions with representatives of Homeland Security regarding the Company's technology and its capabilities in the detection and mitigation of risk.

The Company's 'Net GameLink(TM) system is designed for installation at a relatively modest cost in neighborhood arcade-like gaming centers and social bars. It consists of computers, a networking system, and specially-designed networked kiosks that allow the Company's patrons to play interactive 3D games with either other users at the same location or users at a remote location. The gamestations feature X86 (Intel central processing unit) compatible 3D-game hardware and software. Customers pay for their use of the system through a plastic debit card. Each card is prepaid and is credited with a certain amount of playing time.

Although the Company's immediate focus is on the more-ample opportunities for its virtual reality products in the training/simulation, entertainment/amusement, and advertising/promotion markets, the Company intends to distribute its 'Net GameLink™ product, in conjunction with its current Universe™ amusement line of products, in Company-owned centers and through third-party distribution agreements. The Company expects additional revenue from its 'Net GameLink™ system to be generated through the sale of advertising to companies who wish to reach the Company's demographic market. The Company anticipates that the cost of a system to third parties will be in the range of \$5000-\$6000 per kiosk, including the server for each location. The Company further anticipates, on non-Company owned systems, to receive a royalty based on the amount spent by patrons to actually play on the system equal to 15 percent of revenues, and a royalty on the advertising generated by the 'Net GameLink™ system at each location equal to 50 percent of the advertising revenue paid to the operator.

COMPETITION

Competition within each of the Company's markets is intense.

Competition within the entertainment/amusement market is based primarily on the ability to deliver an exciting and realistic gaming experience beyond what the participant would experience on his or her home computer, through such items as 3-D imaging, sound, and sense of motion. Within the entertainment/amusement market, the Company's advantages are its advanced virtual reality technology, as well as its patented Universe™ Control Board, and its EasyPlay™ overlay software, which when used in the Company's VR Zones, 'Net GameLink™, and in custom applications, can transform any off-the-shelf PC game or application into a coin-op-ready program without requiring source code software modifications to either the PC application or the operating system.

The Company faces extensive competition with companies that supply the advertising/promotion market. However, as the Company's virtual reality experiences are custom applications, and the Company deals primarily with leading advertising agencies, it is difficult to quantify the competition, because the Company is generally not aware of alternative methods considered by these agencies to present their message.

It is difficult to gauge the competition in the training/simulation market, which the Company is in the process of entering. There are several large competitors in this field. For instance, a recent (January 7, 2002) edition of Forbes magazine contains a feature story on L3 Communications, Inc., a company purportedly doing in excess of \$400,000,000.00 with the United States government in this market. However, the Company believes that its products in this market are unique, primarily due to its proprietary 360-degree form of immersive photorealistic virtual reality.

Some general competitors within the virtual reality industry that promote substitute and similar technologies are as follows:

Straylight--since 1992, Straylight has focused on the exploitation of virtual reality in the promotions and conventions market, basing its original customized systems on expensive Silicon Graphics computers. Most recently, it launched the stand-up 3DXTC system, offering a headset-based, lightweight system utilized within the advertising/promotional market. The Company believes Straylight's installed base (under ten units) is insignificant, and that Straylight only sells its product and service to others rather than exploiting the product and service itself.

Virtual World Entertainment--since 1995, VWE has built single high-end enclosed game capsules, commencing with its own center in Chicago around 1995. The Company understands that VWE's products can be found in only a handful of international high-end locations. VWE uses a proprietary system, and thus must develop each game itself, and the Company believes it has released only two games in six years and has an installed base of fewer than 60 units.

Dynavision--since 1996, Dynavision has focused on building a single stand-up headset-based virtual reality entertainment product. Dynavision's Orion system uses PC software, in which the third-party's source code is modified for the Orion system. The Company has been informed that this company was sold in 2000, and since 1999, it has not been seen at any industry tradeshows. The Company does not know whether Dynavision is still in business.

Global VR--since 1997, Global VR has focused on VR Vortek, a single stand-up virtual reality entertainment product utilizing a large viewing device mounted to a steel arm. Global VR recently added products to its line from the bankruptcy purchase of the former Interactive Light company. The Company believes Global VR's installed base is less than that of the Company.

IMAX Corporation--since 1964, IMAX has developed specialized educational and entertaining large-screen movies and theaters, with over 225 locations world-wide. IMAX is recognized as a leader of unique large-screen theaters. It

is the Company's opinion that IMAX's products and movies do not directly compete or exclude any of the Company's products, though it may be regarded as an indirect competitor since customers seeking a virtual reality experiences may instead choose the large-screen theater.

Ham On Rye Technologies--introduced its first system for entertainment use at IAAPA 2000, but had rented equipment for corporate rentals prior to this. The company sells one product -- a 16-seat interactive theater which utilizes a headset for each participant. The system requires a live actor for each showing, who asks the users to press buttons on a small remote control and perform other activities during the show (like patting the tops of their heads). The system uses 2D video compositing technology, and has no traditional virtual reality capabilities (i.e., headtracking, user control of movement or view, etc.). While the system can accommodate large throughput of guests, a single system costs over \$100,000, and Company believes this product's repeat level of use is low. Because of cost and market constraints for this type of product, the Company expects Ham on Rye to have fewer than 25 systems installed worldwide.

Although the Company's focus in the entertainment/amusement market has been on large third-party theme park operations such as Six Flags and Busch Gardens, there is also competition in the form of large gaming centers established by companies such as GameWorks and Dave & Busters. GameWorks was established by Sega Enterprises, Universal Studios, Inc., and DreamWorks SKC, and it was designed under the guidance of Steven Spielberg. GameWorks has far greater financial and technical resources than the Company, and Dave & Busters has far greater financial resources than the Company, and both operations have created entire establishments devoted to various forms of gaming, including virtual reality games. The Company intends to compete by its focus with its Universe™ line of products in large third-party theme park operations, and by providing more but smaller facilities for its 'Net GameLink™ product that will be readily accessible in the gamer's immediate neighborhood, with the companionship of the gamer's neighbors, rather than requiring substantial travel to destination sites such as GameWorks and Dave & Busters.

The above summary of competition is by no means exhaustive, since this is a fluid and rapidly-expanding industry.

MARKETING

The Company's marketing activities are conducted on multiple levels.

With regard to the amusement/entertainment market, marketing is conducted primarily by word-of-mouth within the theme park industry, as well as by marketing efforts conducted by the Company's vice-president of operations. The Company has standing offers to dramatically increase its theme park presence depending upon the availability of capital for expansion.

Marketing within the advertising/promotional market is conducted primarily by the Company's executive vice-president. The Company has a demonstration unit featuring excerpts from its successful promotional projects for Buick, Red Baron Pizza, and Chevrolet. Marketing within this industry is conducted primarily by one-on-one appointments and demonstrations of the Company's technology and previous successful applications to advertising agencies.

The Company is presently negotiating to enter the training/simulation market, primarily in dealing directly with the United States government in the areas of Homeland Security. To aid its attempt to enter this market, the Company has enlisted several consultants, all of whom possess a proven success in procuring governmental contracts and delivering successful training products for previous military and other security applications. However, we cannot give any assurance that we will be successful in entering this market.

EMPLOYEES

At December 31, 2001 the Company employed 22 people. The number of employees utilized by the Company is highly seasonal, due to the Company's seasonal VR Zone operations in theme parks. During the height of the amusement park season, the Company employs as many as 150 people. The Company considers relations with its employees to be satisfactory.

TRADEMARKS

The Company has filed for federal registration of its "Net GameLink(TM)" and "The Internet Just Met Its Match" trademarks, and a patent application is pending for its network-enabled gaming kiosk. There can be no assurance that a patent will issue on this application, or that if the patent is issued it will be sufficiently broad to provide meaningful protection.

Item 2. Description of Property

The Company's executive offices are located in Arlington, Texas, at the offices of Jones & Cannon, P.C. See "Certain Relationships and Related Transactions." Jones & Cannon, P.C. began charging the Company \$1,500 per month for its office space on June 15, 2000, but to date that charge has not been paid. There is no assurance that these offices will remain sufficient for the Company's use, or that the nature of this relationship will continue.

The Company's production offices are located in Phoenix, Arizona, in an office building owned by Ferris Holdings, L.L.C. See Certain Relationships and Related Transactions. Ferris Holdings has charged the Company \$7,700.00 per month for its office space since August of 2000. The Company has a 25 1/2-year lease with Ferris Holdings.

Item 3. Legal Proceedings

In January, 1999, the Company brought suit in the 141st District Court of Tarrant County, Texas, against Robert Elton Bragg, III, the Company's former president. In the suit, the Company claims that Mr. Bragg, while president of the Company, misappropriated funds by paying himself consulting fees although no meaningful services were performed for the Company, and that he threatened, without justification, to attempt to rescind the March 1997 stock-for-stock transaction in which the Company acquired the brewpub/microbrewery operation from First Brewery of Dallas, Inc. In the suit, the Company is asking for 1) a declaratory judgment that the March, 1997 agreement is a valid and binding agreement, 2) an injunction to prevent Bragg from selling his shares in the Company, and 3) damages for misappropriation of the Company's funds. As permitted under Texas law, the Company has not specified in its petition the amount of damages the Company wants from Mr. Bragg. On May 18, 2000, Bragg counterclaimed against the Company and filed a third-party suit against L. Kelly Jones, the Company's chief executive officer. In his counterclaim, Bragg claims that 1) Jones made false representations in connection with the stock-for-stock transaction in March of 1997 between the shareholders of the former First Brewery of Dallas, Inc. and the Company, 2) that Jones breached his fiduciary duties to the Company's shareholders, and 3) that the Company failed to pay Bragg for services he claims he rendered to the Company. The Company believes the counterclaim and third-party action are groundless and are brought in bad faith. The Company has vigorously defended the claims, and is asking for sanctions against Bragg's attorney for bringing the groundless causes of action. The case is currently in pre-trial discovery.

In April of 2001, Entertainment Technologies & Programs, Inc. (**ETPI**) brought suit against the Company in the 215 Judicial District Court of Harris County, Texas. ETPI and the former Ferris Productions, Inc. had entered into a letter of intent relating to a proposed acquisition of Ferris by ETPI. Ferris terminated that letter of intent, and subsequently entered into a letter of intent with the Company, under which Ferris eventually merged into the Company. ETPI claims that Ferris' termination of its letter of intent was in breach of contract, and that the Company tortiously interfered with ETPI's letter of intent with Ferris. ETPI is asking for damages of \$10,000,000. Management believes that the suit is entirely without merit, and intends to vigorously defend it. The case is currently in pre-trial discovery.

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

No matters were submitted to a vote of security holders during the last quarter of the period covered by this report.

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

MARKET INFORMATION

The Company's Common Stock is quoted under the symbol "GAMZ" on the OTC Electronic Bulletin Board. The following table sets forth the high and low bid prices for shares of the Company Common Stock for the periods noted, as reported by the OTC Electronic Bulletin Board. Quotations are on an as-adjusted basis to reflect a 1 for 5 reverse split effected in 1997 and reflect inter dealer prices, without retail markup, mark down or commission and may not represent actual transactions.

YEAR	PERIOD	BID PRICES	
		HIGH	LOW
1999			
	First Quarter	\$0.66	\$0.09
	Second Quarter	1.03	0.26
	Third Quarter	1.22	0.09
	Fourth Quarter	0.70	0.07
2000			
	First Quarter	1.38	0.27
	Second Quarter	1.13	0.31
	Third Quarter	0.63	0.31
	Fourth Quarter	0.47	0.15
2001			
	First Quarter	0.76	0.20
	Second Quarter	0.55	0.14
	Third Quarter	0.51	0.19
	Fourth Quarter	0.33	0.13

As of March 26, 2002, the reported bid price for the Company's common stock was \$0.21 per share.

SHAREHOLDERS

As of March 26, 2002, the Company had 33,992,200 shares of Common Stock outstanding held by 119 shareholders of record.

DIVIDENDS

The Company has not paid cash dividends on its Common Stock in the past and does not anticipate doing so in the foreseeable future.

Item 6.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains certain forward-looking statements that are subject to business and economic risks and uncertainties, and the Company's actual results could differ materially from those forward-looking statements. The following discussion regarding the financial statements of the Company should be read in conjunction with the financial statements and notes thereto.

Overview.

The Company was capitalized in 1996 to develop, own, and operate theme brewpub/microbrewery restaurants. Until March of 1997 when the Company acquired, and July 1, 1997 when the Company began operating, the former Hubcap Brewery & Kitchen in Dallas, Texas, the Company had no operations or revenues and its activities were devoted solely to development. In January, 1999, the Company terminated its brewpub/microbrewery restaurant operations.

In December of 1997, GameCom acquired all rights to 'Net GameLink(TM)', an interactive entertainment system designed to allow a number of players to compete with one another in a game via an intranet or the Internet. From 1999 when it closed its microbrewery operations until it acquired Ferris Productions, Inc. as described below, GameCom had been devoting substantially all of its efforts to implementing the 'Net GameLink(TM)' product and its operations were limited to development, construction and beta-testing of the initial 'Net GameLink(TM)' prototype system at J. Gilligan's Bar and Grill in Arlington, Texas.

In September 2001, the Company completed a reverse merger with Ferris Productions, Inc., in a stock-for-stock transaction under which Ferris shareholders acquired a controlling interest in the Company. The acquisition provides the Company with a wider array of products within the Company's industry, an experienced management team, an

existing revenue stream, established distribution channels, and the opportunity for additional markets.

In addition to the opportunities brought to the Company by the Ferris acquisition, the acquisition also brings the Company substantial debt. There can be no assurances that the Company will successfully implement its expansion plans, including addressing the debt and the anticipated expansion of the former Ferris operations. The Company faces all of the risks, expenses, and difficulties frequently encountered in connection with the expansion and development of a new business, difficulties in maintaining delivery schedules if and when volume increases, the need to develop support arrangements for systems at widely-dispersed physical locations, and the need to control operating and general and administrative expenses. While the Ferris acquisition provided an established stream of revenues, historically favorable gross margins, and potential lucrative markets, Ferris had not yet generated a profit, and substantial additional capital, or major highly-profitable custom applications, will be needed for the Company's operations to become profitable.

Results of Operations.

Fiscal year ended December 31, 2001 compared to fiscal year ended December 31, 2000.

Total revenue for the year ended December 31, 2001 was \$2,463,064 compared to total revenue of \$3,359,126 for the year ended December 31, 2000. This decrease of \$896,062, or 27%, was primarily a result of lower traffic in the theme parks, fewer completed custom application projects in 2001, and the distraction of the GameCom/Ferris merger.

Cost of sales and services decreased \$308,490, or 16%, to \$1,574,399 for the year ended December 31, 2001 from \$1,882,889 for the year ended December 31, 2000. This decrease is a direct result of the decrease in revenue offset by higher depreciation costs of entertainment equipment and fewer completed custom applications in 2001 as compared to 2000.

General and administrative expenses increased by \$309,307, or 14%, to \$2,443,692 for the year ended December 31, 2001 from \$2,134,385 for the year ended December 31, 2000 despite a decrease in revenue. The increase is a result of costs incurred and associated with the GameCom/Ferris merger, a general increase in salaries, consulting fees and professional fees primarily related to research and development of new products, and the continued promotion of the Company's products and services.

Interest expense and finance charges increased by \$283,497, or 24%, to \$1,456,647 for the year ended December 31, 2001 from \$1,173,150 for the year ended December 31, 2000. This increase is a result of a net increase in debt obligations in 2001 and an increase in common stock issued to certain stockholders as an incentive for their additional loans to the Company.

Liquidity and Plan of Operations

On June 5, 2000, the Company announced that it had entered into a subscription agreement for up to a \$15,000,000.00 sale of common stock and warrants under a private equity line contract with Swartz Private Equity, L.L.C. ("Swartz"), an institutional private equity fund. This financing allows the Company to issue common stock and warrants at the Company's discretion as often as monthly as funds are needed in amounts based upon certain market conditions. The pricing of each common stock sale is based upon current market prices at the time of each draw, and the Company may set a floor price for the shares each month at the Company's discretion. The Company's SB-2 registration statement for the Swartz private equity line became effective with the Securities and Exchange Commission on August 10, 2000. The Company made its first draw on the Swartz equity line during the month of October, 2000.

However, it has not made any draws under that line since January of 2001, because the price and volume of trading in the Company's shares has been too low to make that source of financing attractive.

To date the Company has met its capital requirements through capital contributions, loans from principal shareholders and officers, bank borrowings, and certain private placement offerings. For the fiscal year ended December 31, 2001, the net loss from operations was \$(1,555,027). After taking into account the non-cash items included in that loss, the Company's cash requirements were \$(689,277) for operating activities and \$(53,759) for investing activities, or a total of \$(749,415). To cover most of these cash requirements, the Company issued additional shares of its common stock to investors for approximately \$82,279, increased its bank and other borrowings by \$474,524, and borrowed an additional \$152,500 from stockholders. The remaining cash requirement was met by drawing down cash on hand.

The opinions of the Company's independent auditor for each of the last two fiscal years expressed substantial doubt as to the Company's ability to continue as a going concern. The Company will need substantial additional capital or new lucrative custom application projects to become profitable. Assuming that capital becomes available, or the Company is successful in achieving a major custom application project, the Company expects to achieve profitability within the next 12 months.

As of September 15, 2001, the Company entered into a debenture purchase agreement calling for Olympic Holdings, L.L.C. to purchase \$1,000,000 in principal amount of the Company's convertible subordinated debentures at various times from September 15th through November 15, 2001. The debentures were to be convertible into restricted shares of the Company's common stock, at no discount to market price. Olympic defaulted, providing only \$20,000 to the Company, and the Company has obtained a judgment against Olympic for its breach of contract. Olympic's funding was critical in order to cure defaults under the Company's lease obligations, to satisfy certain bank indebtedness, and to expand the Company's theme park operations.

The Company is presently negotiating with several investment bankers and interested financiers with regard to funding necessary for the Company to continue in operation. The Company has not obtained any commitments for that financing, and as a result the Company may not be able to bring certain negotiations for major custom applications to contract fruition.

Item 7.

Financial Statements

#

GAMECOM, INC.

**CONSOLIDATED FINANCIAL STATEMENTS
WITH REPORT OF INDEPENDENT ACCOUNTANTS
for the years ended December 31, 2001 and 2000**

GAMECOM, INC.

TABLE OF CONTENTS

Page(s)

Report of Independent Accountants

10

Consolidated Financial Statements:

Consolidated Balance Sheet as of December 31, 2001

11

Consolidated Statement of Operations for the years ended December 31, 2001 and 2000

12

Consolidated Statement of Cash Flows for the years ended December 31, 2001 and 2000

13

Consolidated Statement of Stockholders Deficit for the years ended December 31, 2001 and 2000

14

Notes to Consolidated Financial Statements

15-25

#

Report of Independent Accountants

To the Board of Directors and Stockholders of

GameCom, Inc.

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

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

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

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses from operations and at December 31, 2001 is in a negative working capital position and a stockholders' deficit position. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Ham, Langston & Brezina, LLP

Houston, Texas

March 20, 2002

#

GAMECOM, INC.
CONSOLIDATED BALANCE SHEET
December 31, 2001

ASSETS

Current assets:

Cash and cash equivalents

\$ -

Accounts receivable

15,669

Total current assets

15,669

Property and equipment, net

822,964

Note receivable-related party

67,885

Intangible assets, net

54,389

Total assets

\$ 960,907

LIABILITIES AND STOCKHOLDERS DEFICIT

Current liabilities:

Notes payable

\$1,079,464

Current portion of obligations under product financing arrangements

1,840,436

Notes payable-stockholders

710,531

Accounts payable

1,020,574

Book overdraft

33,172

Accrued interest payable

146,341

Accrued liabilities

355,365

Total current liabilities

5,185,883

Obligations under product financing arrangements, net of current portion

2,513,914

Total liabilities

7,699,797

Redeemable common stock, 778,291 shares at \$.005 par value

3,891

Stockholders' deficit:

Common stock, \$.005 par value, 100,000,000 shares

authorized, 32,931,842 shares issued and outstanding

164,660

Additional paid-in capital

2,129,589

Accumulated deficit

(9,037,030)

Total stockholders' deficit

(6,742,781)

Total liabilities and stockholders' deficit

\$ 960,907

See accompanying notes to financial statements

#

GAMECOM, INC.

CONSOLIDATED STATEMENT OF OPERATIONS

for the years ended December 31, 2001 and 2000

2001

2000

Revenue:

Theme parks and arcades

\$ 1,763,280

\$ 2,173,025

Custom applications and other

699,784

1,186,101

Total revenue

2,463,064

3,359,126

Cost of sales and services

1,574,399

1,882,889

Gross margin

888,665

1,476,237

General and administrative expenses

2,443,692

2,134,385

Loss from operations

(1,555,027)

(658,148)

Other income (expenses):

Interest income

1,338

1,415

Interest expense and finance charges

(1,456,647)

(1,173,150)

Other income

55,760

22,863

Total other income (expenses)

(1,399,549)

(1,148,872)

Net loss before extraordinary item

(2,954,576)

(1,807,020)

Extraordinary item:

Gain from extinguishment of debt

 -

455,149

Net loss

\$(2,954,576)

\$(1,351,871)

Weighted average shares outstanding

31,758,516

30,400,649

Basic and diluted net loss per common share

before extraordinary item

\$(0.09)

\$(0.06)

Effect of extraordinary item

\$ -

\$ 0.01

Basic and diluted net loss per common share

after extraordinary item

\$ (0.09)

\$ (0.05)

See accompanying notes to financial statements

#

GAMECOM, INC.

CONSOLIDATED STATEMENT OF CASH FLOWS

for the years ended December 31, 2001 and 2000

2001

2000

Cash flows from operating activities:

Net loss

\$(2,954,576)

\$(1,351,871)

Adjustments to reconcile net loss to net cash used

in operating activities:

Depreciation and amortization

610,246

556,701

Amortization of debt issuance costs

517,034

210,854

Bad debt expense

33,471

-

Common stock issued for services

88,225

16,251

Common stock issued for interest and finance charges

225,900

198,696

Changes in operating assets and liabilities:

Accounts receivable

144,253

(159,742)

Prepaid and other assets

38,887

(4,898)

Accounts payable

283,517

(682)

Accrued interest payable

56,401

8,106

Accrued liabilities

267,365

(132,400)

Net cash used in operating activities

(689,277)

(658,985)

Cash flows from investing activities:

Capital expenditures

(88,656)

(930,776)

Increase in intangible asset

-

(22,392)

Issuance of note receivable-related party

-

(102,782)

Payment received on note receivable

34,897

91,529

Net cash used in investing activities

(53,759)

(964,421)

Cash flows from financing activities:

Proceeds from issuance of notes payable

79,990

1,085,000

Proceeds from issuance of notes payable-stockholders

152,500

86,000

Proceeds from obligations under product financing
arrangements

563,860

234,240

Payments on notes payable

(68,326)

(162,200)

Payments on obligations under product financing
arrangements

(101,000)

(90,060)

Increase in book overdraft

27,598

5,574

Proceeds from issuance of common stock

82,279

64,847

Net cash provided by financing activities

736,901

1,223,401

Increase (decrease) in cash and cash equivalents

(6,135)

(400,005)

Cash and cash equivalents, beginning of year

6,135

406,140

Cash and cash equivalents, end of year

\$ -

\$ 6,135

Supplemental disclosure of cash flow information:

Cash paid for interest expense

\$ 657,312

\$ 733,995

Cash paid for income taxes

\$ -

\$ -

Non-cash activity:

During 2001 \$50,000 of notes payable to a stockholder was converted into the Company's common stock.

See accompanying notes to financial statements

#

GAMECOM, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS DEFICIT

for the years ended December 31, 2001 and 2000

	Common Stock <u>Shares</u>	<u>Amount</u>	Additional Paid-In <u>Capital</u>	Accumulated <u>Deficit</u>	<u>Total</u>
Balance at December 31, 1999	28,389,040	\$ 141,945	\$1,422,470	\$(4,730,583)	\$(3,166,168)
Common stock issued for services	84,571	423	15,828	-	16,251
Common stock issued for interest and finance charges	1,133,967	5,670	193,026	-	198,696
Common stock issued for cash	127,694	638	64,209	-	64,847
Expiration of redeemable common stock	727,108	3,636	-	-	3,636
Net loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,351,871)</u>	<u>(1,351,871)</u>
Balance at December 31, 2000	30,462,380	152,312	1,695,533	(6,082,454)	(4,234,609)
Common stock issued for services	333,661	1,668	86,557	-	88,225
Common stock issued for interest and finance charges	1,400,492	7,003	218,897	-	225,900
Common stock issued for cash	485,309	2,427	79,852	-	82,279
Common stock issued as repayment of notes to stockholders	250,000	1,250	48,750	-	50,000
Net loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2,954,576)</u>	<u>(2,954,576)</u>
Balance at December 31, 2001	<u>32,931,842</u>	<u>\$ 164,660</u>	<u>\$2,129,589</u>	<u>\$(9,037,030)</u>	<u>\$(6,742,781)</u>

See accompanying notes to financial statements

#

GAMECOM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1.

Background and Summary of Significant Accounting Policies

Background

GameCom, Inc. (GameCom), a Texas corporation, was founded in 1996 and is currently headquartered in Arlington, Texas. Effective September 21, 2001 GameCom merged with Ferris Productions, Inc. (Ferris) (together the Company). Ferris, which was based in Phoenix, Arizona, develops, manufactures and operates technically advanced personal computer and non-personal computer based products including virtual reality (VR) entertainment products for the entertainment, simulation, promotion and education industries.

GameCom's merger with Ferris was effected by issuing 18,072,289 shares of GameCom common stock for all of the outstanding common stock of Ferris. The merger, since it was initiated prior to June 30, 2001, is accounted for as a pooling of interests in the accompanying consolidated financial statements. The pooling of interest method of accounting assumes that Gamecom and Ferris have been merged since their inception and the consolidated financial statements for periods prior to the consummation of the merger are restated as though the companies have been combined since their inception. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates.

Revenue Recognition

Revenue is recognized at the time services are performed or when products are shipped.

Deferred Revenue and Expenses

Deferred revenue represents advanced billings on custom application projects and is recognized as revenue in the year the work is performed. Deferred expenses represent expenses incurred related to custom application projects not recognized until the work commences.

Concentrations of Credit Risk

Financial instruments which subject the Company to concentrations of credit risk include cash and cash equivalents and accounts receivable.

The Company maintains its cash in well known banks selected based upon management's assessment of the banks financial stability. Balances periodically exceed the \$100,000 federal depository insurance limit; however, the Company has not experienced any losses on deposits.

Accounts receivable generally arise from sales of equipment and services to various companies throughout the world and from revenue sharing arrangements with certain theme parks located throughout the United States. Collateral is generally not required for credit granted. During the years ended December 31, 2001 and 2000 the Company had two customers representing 49% and 52% of its total revenue, respectively.

Continued

#

GAMECOM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cash Equivalents

For purposes of reporting cash flows, the Company considers all short-term investments with an original maturity of three months or less to be cash equivalents.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets, which range from three to seven years. Expenditures for major renewals and betterments that extend the original estimated economic useful lives of the applicable assets are capitalized. Expenditures for normal repairs and maintenance are charged to expense as incurred. The cost and related accumulated depreciation of assets sold or otherwise disposed of are removed from the accounts, and any gain or loss is included in operations.

Intangible Assets

Intangible assets consist of direct costs incurred in developing proprietary technology exclusively used in its entertainment products and costs incurred in obtaining a patent on such technology. The intangible assets are being amortized on a straight-line basis over a five-year period. As of December 31, 2001, accumulated amortization of these intangible assets is \$36,260. During each of the years ended December 31, 2001 and 2000, the Company recorded amortization expense of \$18,130.

Debt Issuance Costs

Debt issuance costs are deferred and recognized, using the interest method, over the term of the related debt.

Shipping and Delivery Costs

The cost of shipping and delivery of arcade games are charged directly to cost of sales and service at the time of shipment.

Income Taxes

The Company uses the liability method of accounting for income taxes. Under this method, deferred income taxes are recorded to reflect the tax consequences on future years of temporary differences between the tax basis of assets and liabilities and their financial amounts at year-end. The Company provides a valuation allowance to reduce deferred tax assets to their net realizable value.

Loss Per Share

Basic and diluted loss per share is computed on the basis of the weighted average number of shares of common stock outstanding during each period. Common equivalent shares from common stock options and warrants are excluded from the computation as their effect would dilute the loss per share for all periods presented.

Stock-Based Compensation

The Company accounts for its stock compensation arrangements under the provisions of Accounting Principles Board (APB) No. 25 Accounting for Stock Issued to Employees . The Company provides disclosure in accordance with the disclosure-only provisions of Statement of Financial Accounting Standard (SFAS) No. 123 Accounting for Stock-Based Compensation .

Impairment of Long-Lived Assets

In the event that facts and circumstances indicate that the carrying value of a long-lived asset, including associated intangibles, may be impaired, an evaluation of recoverability is performed by comparing the estimated future

undiscounted cash flows associated with the asset or the asset's estimated fair value to the asset's carrying amount to determine if a write-down to market value or discounted cash flow is required.

Fair Value of Financial Instruments

The Company includes fair value information in the notes to financial statements when the fair value of its financial instruments is different from the book value. When the book value approximates fair value, no additional disclosure is made.

Comprehensive Income

The Company has adopted SFAS No. 130, Reporting Comprehensive Income. Comprehensive income includes such items as unrealized gains or losses on certain investment securities and certain foreign currency translation adjustments. The Company's financial statements include none of the additional elements that affect comprehensive income. Accordingly, comprehensive income and net income are identical.

Segment Information

The Company has adopted SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. SFAS No. 131 supersedes SFAS No. 14, Financial Reporting for Segments of a Business Enterprise. Under the new standard, the Company is required to use the management approach to reporting its segments. The management approach designates that the internal organization that is used by management for making operating decisions and assessing performance as the source of the Company's segments. The accounting policies of the segments are the same as those described elsewhere in Note 1.

Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued Financial Accounting Standard (SFAS) No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 eliminates the amortization of goodwill and requires that goodwill be reviewed annually for impairment. SFAS No. 142 also requires that the useful lives of previously recognized intangible assets be reassessed and the remaining amortization periods be adjusted accordingly. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001 and affects all goodwill and other intangible assets recorded on the Company's balance sheet at that date, regardless of when the assets were initially recorded. The implementation of SFAS No. 142 is not expected to have a material impact on the Company's results of operations or financial position.

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations . SFAS No. 143 addresses accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement is effective for fiscal years beginning after June 15, 2002. The Company does not expect the implementation of SFAS No. 143 to have a material impact on the Company's results of operation or financial position.

In July 2001, the FASB issued SFAS No. 144, Impairment or Disposal of Long-Lived Assets , which is effective for fiscal years beginning after December 15, 2001. The provisions of this statement provide a single accounting model for impairment of long-lived assets. The Company does not expect the implementation of SFAS No. 144 to have a material impact on the Company's results of operation or financial position.

2.

Going Concern Considerations

During the years ended December 31, 2001 and 2000, the Company has defaulted on its notes payable, has continued to accumulate payables to its vendors and has experienced negative financial results as follows:

	<u>2001</u>	<u>2000</u>
Net loss	\$(2,954,576)	\$(1,351,871)
Negative cash flows from operations	(689,277)	(658,985)
Negative working capital	(5,170,214)	-
Accumulated deficit	(9,037,030)	-
Stockholders' deficit	(6,742,781)	-

Management has developed specific current and long-term plans to address its viability as a going concern as follows:

-

The Company's anticipated entry into the training/simulation market was advanced by the aftermath of September 11, 2001. The Company is currently in advanced discussions with representatives of Homeland Security of the U.S. Government regarding use of the Company's technology in detecting and mitigating the risk of similar problems in the future.

•

The Company is also attempting to raise funds through debt and/or equity offerings. If successful, these additional funds would be used to pay down debt and for working capital purposes.

•

In the long-term, the Company believes that cash flows from continued growth in its operations will provide the resources for continued operations.

There can be no assurance that the Company's debt reduction plans will be successful or that the Company will have the ability to implement its business plan and ultimately attain profitability. The Company's long-term viability as a going concern is dependent upon three key factors, as follows:

•

The Company's ability to obtain adequate sources of debt or equity funding to meet current commitments and fund the continuation of its business operations in the near term.

•

The ability of the Company to control costs and expand revenues from existing or new businesses.

•

The ability of the Company to ultimately achieve adequate profitability and cash flows from operations to sustain its operations.

3.

Accounts Receivable

Accounts receivable consist primarily of amounts due from certain companies for the purchase of equipment and services. An allowance for doubtful accounts is provided, when appropriate, based on past experience and other factors which, in management's judgment, deserve current recognition in estimating probable bad debts. Such factors include circumstances with respect to specific accounts receivable, growth and composition of accounts receivable, the relationship of the allowance for doubtful accounts to accounts receivable and current economic conditions. As of December 31, 2001 all accounts receivable are considered collectible and the allowance for doubtful accounts is \$-0-

4.

Property and Equipment

Property and equipment consisted of the following at December 31, 2001:

Arcade equipment	\$1,795,612
Furniture and equipment	<u>277,314</u>
	2,072,926
Less: accumulated depreciation	<u>(1,249,962)</u>
Property and equipment, net	<u>\$ 822,964</u>

Depreciation expense for the years ended December 31, 2001 and 2000 was \$582,017 and \$528,471, respectively.

5.

Notes Payable

Notes payable consist of the following at December 31, 2001:

Notes payable to a bank, bearing interest ranging from the prime rate (4.75% at December 31, 2001) to the prime rate plus 2% per year and due in average monthly payments of approximately \$31,000, including interest, through November 2002. These notes are collateralized by certain equipment, licensing rights and by the personal guarantees of officers/stockholders of the Company.

\$ 559,474

250,000

Notes payable to banks, bearing interest from 6.75% to 9.5% per year, interest due monthly and principal due on demand. These notes are not collateralized but are guaranteed by officers/stockholders of the Company. Effective January 17, 2002, certain of these notes were refinanced into a single note which bears interest at the prime rate (4.75% at December 31, 2001) plus 1.5%, due in 36 monthly installments of \$8,824 and collateralized by an office building owned by an officer/stockholder of the Company.

250,000

Notes payable to third party entities and individuals bearing interest at a stated rate of 10% payable semi-annually with principal due three years after issuance of the note, which ranges from October 2001 to March 2002. These notes are not collateralized. In connection with the funding of these notes, Ferris issued a total of 412,500 shares of its common stock as equity attachments to the note holders and to pay debt issuance costs. Accordingly, the actual weighted average interest rate on these notes, including the effect of the issuance of common stock and the payment of debt issuance costs, was approximately 16%.

19,990

Note payable to a financing entity, due on demand, non-interest bearing. This note is not collateralized.

Total notes payable

\$1,079,464

The notes payable to banks contain various financial and non-financial covenants, which require the Company, among other things, to maintain certain levels of stockholders equity and to comply with certain financial ratios. The Company was in violation of these covenants as of December 31, 2001 and the banks could demand full payment of all principal and interest.

6.

Notes Payable-Stockholders

Notes payable to stockholders consisted of the following at December 31, 2001:

Convertible notes payable to stockholders, principal and interest due on demand, accruing interest at 12% per year. These notes are collateralized by certain equipment and contain a provision to convert the note to common stock.	\$ 100,000
	194,031
Note payable to a stockholder, principal and interest due on demand, interest accrues at 10% per year. This note is not collateralized.	<u>416,500</u>
Notes payable to stockholders, non-interest bearing with principal due on demand. These notes are not collateralized.	<u>\$ 710,531</u>
Total notes payable to stockholders	

All notes due to stockholders were in default as of December 31, 2001. Convertible notes payable to stockholders in the amount of \$100,000 were issued by the Company in increments of \$10,000 having an original maturity date of May 10, 1998. The holder of each \$10,000 of convertible note has a non-assignable option to purchase 7,500 shares of common stock at par value. Alternately, each holder has the right to convert their convertible note to equity in the form of 12,500 shares of restricted common stock. None of the notes have been converted.

Of the \$416,500 of notes payable without interest described above, a \$103,500 note provides for a per diem issuance of common stock as penalty for late payments. As of December 31, 2001, the per diem issuance would be in excess of 5,800,000 shares of the Company's common stock. The Company has received an opinion from counsel that the penalty provisions are unenforceable as illegal usury under applicable Texas law. However, there has not been any litigation between the Company and the holder of the note as to this issue, and in the absence of a court decision directly applicable to the parties, there remains at least some risk that the opinion of counsel could be wrong.

According to legal counsel there is no likelihood of a sustainable assessment of the per diem late penalty. Therefore, no provision for such charges has been provided.

7.

Obligations Under Product Financing Arrangements

In financing the production of its arcade equipment, the Company has entered into agreements whereby an entity or individual advances funds to the Company to produce specific arcade equipment. Under this arrangement, the Company has agreed to make monthly payments of a specified amount for three years, with an automatic renewal for an additional three years unless canceled in writing, from the origination date as specified in the agreement. In addition, the entity or individual advancing the funds has the right to exercise a buy-out whereby the Company has

180 days to repay the obligation upon exercise of the buy-out. Interest is payable monthly at an annual rate of approximately 16%.

In connection with these financing arrangements, the Company has incurred debt issuance costs of approximately 21% of the total obligation. These costs are being amortized over a three year period using the interest method resulting in an effective annual interest rate of approximately 29% on these obligations.

Obligations under these product financing arrangements consist of the following at December 31, 2001:

Contractual balance	\$4,569,796
	<u>(215,446)</u>
Less: unamortized debt issuance costs	
	<u>\$4,354,350</u>
Total obligation	

As of December 31, 2001, the Company was in default of its obligations under the product financing arrangements. The Company has not made any interest payments on these obligations since September 2001 and has received notices from various individuals and entities requesting buyouts of approximately \$1,350,000 as of december 31, 2001.

8.

Income Taxes

The Company has incurred losses since its inception and, therefore, has not been subject to federal income taxes. As of December 31, 2001, the Company had net operating loss (NOL) carryforwards for income tax purposes of approximately \$8,500,000 which expire in various tax years through 2021. Under the provisions of Section 382 of the Internal Revenue Code the ownership change in the Company that resulted from the merger of the Company could severely limit the Company's ability to utilize its NOL carryforward to reduce future taxable income and related tax liabilities. Additionally, because United States tax laws limit the time during which NOL carryforwards may be applied against future taxable income, the Company may be unable to take full advantage of its NOL for federal income tax purposes should the Company generate taxable income.

The composition of deferred tax assets and liabilities and the related tax effects at December 31, 2001 are as follows:

Deferred tax assets:	
Net operating losses	\$2,912,633
Intangible assets	8,219
Valuation allowance	<u>(2,820,112)</u>
 Total deferred tax assets	 <u>100,740</u>
Deferred tax liabilities:	
Property and equipment	<u>(100,740)</u>
 Total deferred tax liability	 <u>(100,740)</u>
 Net deferred tax asset (liability)	 \$ <u> -</u>

The difference between the income tax benefit in the accompanying statement of operations and the amount that would result if the U.S. Federal statutory rate of 34% were applied to pre-tax loss for the years ended December 31, 2001 and 2000 is as follows:

	2001		2000	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Benefit for income tax at federal statutory rate	\$(1,004,556)	(34.0)%	\$ (459,636)	(34.0)
Other	9,323	0.0	(37,400)	(0.3)
Increase in valuation allowance	<u>995,233</u>	<u>34.0</u>	<u>497,036</u>	<u>34.3</u>
	<u>\$ -</u>	<u>0.0%</u>	<u>\$ -</u>	<u>0.0%</u>

9.

Redeemable Common Stock

In 1997 the Company entered into an agreement to redeem 1,505,399 shares of common stock from certain stockholders at par value of \$.005 per share with the consideration for such redemption to be paid pro-rata to such stockholders by March 31, 1998. In February 2000 the Company and stockholders released 727,108 shares of common stock from the redemption requirement, leaving 778,291 shares to be redeemed. As of December 31, 2001 none of the shares have been redeemed but may be redeemed at the option of the Company.

10.

Stock Options and Warrants

The Company periodically issues incentive stock options to key employees, officers, directors and outside consultants to provide additional incentives to promote the success of the Company's business and to enhance the ability to attract and retain the services of qualified persons.

In 1997 and 1998 the Company granted incentive stock options to certain officers and members of the Company's board of directors to purchase 1,499,000 shares of the Company's common stock at par value of \$.005 per share. These options are exercisable based on various levels of the Company's stock price: (i) options to purchase 333,000 shares at par value are exercisable if the Company's stock is trading at \$1.50 per share; (ii) options to purchase 583,000 shares at par value are exercisable if the Company's stock is trading at \$3.00 per share; (iii) options to purchase 333,000 shares at par value are exercisable if the Company's stock is trading at \$4.50 per share; and (iv) options to purchase 250,000 shares at par value are exercisable if the Company's common stock is trading at \$5.00 per share. In 1999, options to purchase 300,000 shares of common stock were exercised. There is no expiration date on these options.

In 1997 and 1998 in connection with the convertible notes payable to certain stockholders (See Note 6) the Company granted options to purchase 75,000 shares of its common stock, at its par value of \$.005 per share, to these convertible note holders.

On January 1, 2000 the Company granted options to certain employees and non-employees to purchase 350,000 shares of the Company's common stock at \$0.15 per share, which approximated fair market value. The options are fully vested and exercisable at the date of grant and expire on January 1, 2003.

In July 2001 options to purchase 150,000 shares of common stock were granted to a consultant as inducement for services to be provided to the Company. The options are exercisable at (i) the closing bid price per share on the date of grant for 50,000 shares; (ii) the closing bid price at the date of grant plus \$.50 per share for 50,000 shares; and (iii) the closing bid price at the date of grant plus \$1.00 per share for 50,000 shares. These options expire five years from the date of grant. The Company deemed the value of these options to be immaterial at the date of grant.

On June 1, 2001 the Company granted options to an employee to purchase 100,000 shares of the Company's common stock at \$0.49 per share, which was the fair market value of the common stock on the date of grant. The options are exercisable on June 1, 2002.

In September 2001 the Company granted incentive stock options to certain officers and members of the Company's board of directors to purchase 1,499,000 shares of the Company's common stock at par value of \$.005 per share.

These options are exercisable based on various levels of the Company's stock price: (i) options to purchase 333,000 shares at par value are exercisable if the Company's stock is trading at \$1.50 per share; (ii) options to purchase 583,000 shares at par value are exercisable if the Company's stock is trading at \$3.00 per share; (iii) options to purchase 333,000 shares at par value are exercisable if the Company's stock is trading at \$4.50 per share; and (iv) options to purchase 250,000 shares at par value are exercisable if the Company's common stock is trading at \$5.00 per share.

There is no expiration date on these options.

In September 2001, the Company's stockholders amended the 2000 Incentive Stock Option Plan (the Plan). The stockholders have authorized 6,000,000 shares for the Plan and options granted under the Plan may be either incentive stock options or non-statutory stock options subject to certain restrictions as specified in the Plan. During the year ended December 31, 2001 no options have been granted under this Plan.

The Company has elected to follow Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related Interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under FASB Statement No. 123, Accounting for Stock-Based Compensation, requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of the Company's employee stock options is greater equals the fair market price of lighting stock on the date of grant, no compensation expense has been recognized.

Proforma information regarding net income and earnings per share is required by Statement 123, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model, with the following weighted average assumptions for 2001 and 2000:

risk free interest rate of 5%; no dividend yield; weighted average volatility factor of the expected market price of the Company's common stock of 70%; and a weighted average expected life of the options of 1 to 5 years. For purposes of proforma disclosures, the estimated fair value of the options is included in expense at the date of issuance, as required by Statement 123. The Company's proforma information is as follows: