

COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE SAO PAULO-SABESP

Form 6-K

December 06, 2017

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 6-K

REPORT OF FOREIGN ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16 OF THE
SECURITIES EXCHANGE ACT OF 1934

For December, 2017
(Commission File No. 1-31317)

Companhia de Saneamento Básico do Estado de São Paulo - SABESP
(Exact name of registrant as specified in its charter)

Basic Sanitation Company of the State of Sao Paulo - SABESP
(Translation of Registrant's name into English)

Rua Costa Carvalho, 300
São Paulo, S.P., 05429-900
Federative Republic of Brazil
(Address of Registrant's principal executive offices)

Indicate by check mark whether the registrant files or will file
annual reports under cover Form 20-F or Form 40-F.

Form 20-F Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K
in paper as permitted by Regulation S-T Rule 101(b)(1) .

Indicate by check mark if the registrant is submitting the Form 6-K
in paper as permitted by Regulation S-T Rule 101(b)(7) .

Indicate by check mark whether the registrant by furnishing the
information contained in this Form is also thereby furnishing the
information to the Commission pursuant to Rule 12g3-2(b) under
the Securities Exchange Act of 1934.

Yes No

If "Yes" is marked, indicated below the file number assigned to the registrant in connection with Rule 12g3-2(b):

ITR – Quarterly Information Form – 9/30/2017 - CIA SANEAMENTO BÁSICO
ESTADO SÃO PAULO

Version : 1

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Company Information / Capital Breakdown

| Number of Shares (Units) | Current Quarter 9/30/2017 |
|-------------------------------------|--------------------------------------|
| Paid-in Capital | |
| Common | 683,509,869 |
| Preferred | 0 |
| Total | 683,509,869 |
| Treasury Shares | |
| Common | 0 |
| Preferred | 0 |
| Total | 0 |

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Company Information / Cash Proceeds

| Event | Approval | Proceeds | Date of Payment | Type of Share | Class of Share | Earnings per share (Reais / share) |
|-----------------------------|-----------|---------------------|-----------------|---------------|----------------|---------------------------------------|
| Board of Directors' Meeting | 3/27/2017 | Interest on Capital | 6/27/2017 | Common | | |

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Parent Company's Financial Statements / Statement of Financial Position – Assets**(R\$ thousand)**

| Code | Description | Current Quarter | Previous Year |
|---------------|---|-----------------|---------------|
| | | 9/30/2017 | 12/31/2016 |
| 1 | Total Assets | 38,373,427 | 36,745,034 |
| 1.01 | Current Assets | 4,113,112 | 3,823,635 |
| 1.01.01 | Cash and Cash Equivalents | 2,101,000 | 1,886,221 |
| 1.01.03 | Accounts Receivable | 1,758,262 | 1,760,025 |
| 1.01.03.01 | Trade Receivables | 1,581,066 | 1,557,472 |
| 1.01.03.02 | Other Receivables | 177,196 | 202,553 |
| 1.01.03.02.01 | Related-Party Balances | 177,196 | 202,553 |
| 1.01.04 | Inventories | 123,238 | 58,002 |
| 1.01.06 | Recoverable Taxes | 11,047 | 42,633 |
| 1.01.06.01 | Current Recoverable Taxes | 11,047 | 42,633 |
| 1.01.08 | Other Current Assets | 119,565 | 76,754 |
| 1.01.08.03 | Other | 119,565 | 76,754 |
| 1.01.08.03.01 | Restricted Cash | 15,229 | 24,078 |
| 1.01.08.03.20 | Other Receivables | 104,336 | 52,676 |
| 1.02 | Noncurrent Assets | 34,260,315 | 32,921,399 |
| 1.02.01 | Long-Term Assets | 1,222,464 | 1,283,164 |
| 1.02.01.03 | Accounts Receivable | 157,867 | 153,834 |
| 1.02.01.03.01 | Trade Receivables | 157,867 | 153,834 |
| 1.02.01.06 | Deferred Taxes | 108,550 | 186,345 |
| 1.02.01.06.01 | Deferred Income Tax and Social Contribution | 108,550 | 186,345 |
| 1.02.01.08 | Receivables from Related Parties | 649,334 | 669,156 |
| 1.02.01.08.03 | Receivables from Controlling Shareholders | 649,334 | 669,156 |
| 1.02.01.09 | Other Noncurrent Assets | 306,713 | 273,829 |
| 1.02.01.09.04 | Escrow Deposits | 105,708 | 77,915 |
| 1.02.01.09.05 | ANA – Water National Agency | 73,363 | 81,221 |
| 1.02.01.09.20 | Other Receivables | 127,642 | 114,693 |

| | | | |
|---------------|-------------------------------|------------|------------|
| 1.02.02 | Investments | 93,695 | 89,064 |
| 1.02.02.01 | Equity Investments | 35,795 | 31,096 |
| 1.02.02.01.04 | Other Equity Investments | 35,795 | 31,096 |
| 1.02.02.02 | Investment Properties | 57,900 | 57,968 |
| 1.02.03 | Property, Plant and Equipment | 259,737 | 302,383 |
| 1.02.04 | Intangible Assets | 32,684,419 | 31,246,788 |
| 1.02.04.01 | Intangible Assets | 32,684,419 | 31,246,788 |
| 1.02.04.01.01 | Concession Contracts | 8,887,097 | 8,864,607 |
| 1.02.04.01.02 | Program Contracts | 7,860,371 | 7,399,237 |
| 1.02.04.01.03 | Services Contracts | 15,489,172 | 14,552,707 |
| 1.02.04.01.04 | Software License | 447,779 | 430,237 |

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Parent Company's Financial Statements / Statement of Financial Position – Assets (R\$ thousand)

(R\$ thousand)

| Code | Description | Current Quarter | Previous Year |
|---------------|---|-----------------|---------------|
| | | 9/30/2017 | 12/31/2016 |
| 2 | Total Liabilities | 38,373,427 | 36,745,034 |
| 2.01 | Current Liabilities | 3,724,837 | 4,302,508 |
| 2.01.01 | Labor and Pension Plan Liabilities | 598,330 | 458,299 |
| 2.01.01.01 | Social Security Liabilities | 12,192 | 43,257 |
| 2.01.01.02 | Labor Liabilities | 586,138 | 415,042 |
| 2.01.02 | Trade Payable | 284,833 | 311,960 |
| 2.01.02.01 | Domestic Suppliers | 284,833 | 311,960 |
| 2.01.03 | Tax Liabilities | 128,115 | 168,757 |
| 2.01.03.01 | Federal Tax Liabilities | 120,613 | 159,176 |
| 2.01.03.01.01 | Income Tax and Social Contribution Payable | 15,107 | 0 |
| 2.01.03.01.02 | PIS-PASEP and COFINS Payable | 59,722 | 49,132 |
| 2.01.03.01.03 | INSS (social security contribution) Payable | 34,676 | 35,376 |
| 2.01.03.01.20 | Other Federal Taxes | 11,108 | 74,668 |
| 2.01.03.03 | Municipal Tax Liabilities | 7,502 | 9,581 |
| 2.01.04 | Borrowings and Financing | 1,388,013 | 1,246,567 |
| 2.01.04.01 | Borrowings and Financing | 721,166 | 635,701 |
| 2.01.04.01.01 | In Domestic Currency | 274,439 | 269,042 |

| | | | |
|---------------|--|------------|------------|
| 2.01.04.01.02 | In Foreign Currency | 446,727 | 366,659 |
| 2.01.04.02 | Debentures | 647,791 | 595,952 |
| 2.01.04.03 | Financing through Finance Lease | 19,056 | 14,914 |
| 2.01.05 | Other Liabilities | 666,925 | 1,386,591 |
| 2.01.05.01 | Payables to Related Parties | 881 | 1,853 |
| 2.01.05.01.03 | Payables to Controlling Shareholders | 881 | 1,853 |
| 2.01.05.02 | Other | 666,044 | 1,384,738 |
| 2.01.05.02.01 | Dividends and Interest on Capital Payable | 276 | 700,034 |
| 2.01.05.02.04 | Services Payable | 386,209 | 460,054 |
| 2.01.05.02.05 | Refundable Amounts | 11,014 | 12,240 |
| 2.01.05.02.06 | Program Contract Commitments | 129,425 | 109,042 |
| 2.01.05.02.07 | Public-Private Partnership - PPP | 33,865 | 31,898 |
| 2.01.05.02.09 | Indemnities | 10,567 | 9,379 |
| 2.01.05.02.20 | Other Liabilities | 94,688 | 62,091 |
| 2.01.06 | Provisions | 658,621 | 730,334 |
| 2.01.06.01 | Tax, Social Security, Labor and Civil Provisions | 184,921 | 180,165 |
| 2.01.06.01.01 | Tax Provisions | 36,466 | 27,677 |
| 2.01.06.01.02 | Social Security and Labor Provisions | 47,428 | 47,873 |
| 2.01.06.01.04 | Civil Provisions | 101,027 | 104,615 |
| 2.01.06.02 | Other Provisions | 473,700 | 550,169 |
| 2.01.06.02.03 | Provisions for Environmental Liabilities and Decommissioning | 17,475 | 10,691 |
| 2.01.06.02.04 | Provisions for Customers | 380,616 | 462,965 |
| 2.01.06.02.05 | Provisions for Suppliers | 75,609 | 76,513 |
| 2.02 | Noncurrent Liabilities | 17,385,403 | 17,023,315 |
| 2.02.01 | Borrowings and Financing | 10,499,758 | 10,717,576 |
| 2.02.01.01 | Borrowings and Financing | 7,077,838 | 7,244,771 |
| 2.02.01.01.01 | In Domestic Currency | 2,120,641 | 1,951,067 |
| 2.02.01.01.02 | In Foreign Currency | 4,957,197 | 5,293,704 |
| 2.02.01.02 | Debentures | 2,881,944 | 2,935,203 |

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ESTADO SÃO PAULO

Version : 1

Parent Company's Financial Statements / Statement of Financial Position – Liabilities (R\$ thousand)

(R\$ thousand)

| Code | Description | Current Quarter | Previous Year |
|---------------|--|-----------------|---------------|
| | | 9/30/2017 | 12/31/2016 |
| 2.02.01.03 | Financing through Finance Lease | 539,976 | 537,602 |
| 2.02.02 | Other Liabilities | 6,442,485 | 5,862,998 |
| 2.02.02.02 | Other | 6,442,485 | 5,862,998 |
| 2.02.02.02.04 | Pension Plan Liabilities | 3,332,955 | 3,265,250 |
| 2.02.02.02.05 | Program Contract Commitments | 81,872 | 69,051 |
| 2.02.02.02.06 | Public-Private Partnership - PPP | 2,749,339 | 2,217,520 |
| 2.02.02.02.07 | Indemnities | 26,836 | 11,247 |
| 2.02.02.02.08 | Labor Liabilities | 6,247 | 29,625 |
| 2.02.02.02.09 | Deferred COFINS/PASEP | 132,243 | 138,071 |
| 2.02.02.02.20 | Other Liabilities | 112,993 | 132,234 |
| 2.02.04 | Provisions | 443,160 | 442,741 |
| 2.02.04.01 | Tax, Social Security, Labor and Civil Provisions | 287,428 | 287,590 |
| 2.02.04.01.01 | Tax Provisions | 39,780 | 39,234 |
| 2.02.04.01.02 | Social Security and Labor Provisions | 239,760 | 234,338 |
| 2.02.04.01.04 | Civil Provisions | 7,888 | 14,018 |
| 2.02.04.02 | Other Provisions | 155,732 | 155,151 |
| 2.02.04.02.03 | Provisions for Environmental Liabilities and Decommissioning | 145,250 | 138,431 |
| 2.02.04.02.04 | Provisions for Customers | 6,265 | 12,074 |
| 2.02.04.02.05 | Provisions for Suppliers | 4,217 | 4,646 |
| 2.03 | Equity | 17,263,187 | 15,419,211 |
| 2.03.01 | Paid-Up Capital | 10,000,000 | 10,000,000 |
| 2.03.04 | Profit Reserve | 6,182,140 | 6,244,859 |
| 2.03.04.01 | Legal Reserve | 932,310 | 932,310 |
| 2.03.04.08 | Additional Dividend Proposed | 0 | 62,719 |
| 2.03.04.10 | Reserve for Investments | 5,249,830 | 5,249,830 |

| | | | |
|---------|--------------------------------------|-----------|----------|
| 2.03.05 | Retained Earnings/Accumulated Losses | 1,906,695 | 0 |
| 2.03.06 | Equity Valuation Adjustments | -825,648 | -825,648 |

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Parent Company's Financial Statements / Statement of Financial Position – Liabilities (R\$ thousand)

(R\$ thousand)

| Code | Description | Current Quarter 7/01/2017 to 9/30/2017 | YTD Current Year 1/01/2017 to 9/30/2017 | Same Quarter Previous Year 7/01/2016 to 9/30/2016 | YTD Previous Year 1/01/2016 to 9/30/2016 |
|------------|---|---|--|--|---|
| 3.01 | Revenue from Sales and/or Services | 3,536,444 | 10,589,904 | 3,745,807 | 10,212,238 |
| 3.02 | Cost of Sales and/or Services | -2,047,318 | -6,350,177 | -2,236,740 | -6,445,167 |
| 3.02.01 | Cost of Sales and/or Services | -1,352,848 | -4,184,251 | -1,163,280 | -3,881,934 |
| 3.02.02 | Construction Cost | -694,470 | -2,165,926 | -1,073,460 | -2,563,233 |
| 3.03 | Gross Profit | 1,489,126 | 4,239,727 | 1,509,067 | 3,767,071 |
| 3.04 | Operating Income/Expenses | -342,671 | -1,301,297 | -445,478 | -1,235,752 |
| 3.04.01 | Selling Expenses | -124,619 | -576,737 | -234,226 | -574,446 |
| 3.04.02 | General and Administrative Expenses | -233,926 | -766,974 | -218,041 | -691,513 |
| 3.04.04 | Other Operating Income | 22,852 | 46,135 | 12,671 | 42,421 |
| 3.04.04.01 | Other Operating Income | 27,601 | 56,884 | 16,150 | 53,421 |
| 3.04.04.02 | COFINS and PASEP | -4,749 | -10,749 | -3,479 | -11,000 |
| 3.04.05 | Other Operating Expenses | -8,210 | -8,420 | -6,407 | -14,492 |
| 3.04.05.01 | Loss on Write-off of Property, Plant and Equipment Items | -119 | 1,853 | -2,826 | -7,310 |
| 3.04.05.03 | Tax Incentives | -7,248 | -7,980 | -3,570 | -3,570 |
| 3.04.05.04 | Surplus Cost of Electricity Sold | -145 | -1,396 | 0 | -3,102 |
| 3.04.05.20 | Other | -698 | -897 | -11 | -510 |
| 3.04.06 | Equity Results | 1,232 | 4,699 | 525 | 2,278 |
| 3.05 | Income before Financial Result and Taxes | 1,146,455 | 2,938,430 | 1,063,589 | 2,531,319 |
| 3.06 | Financial Result | 222,869 | -54,549 | -176,810 | 536,070 |
| 3.06.01 | Financial Income | 105,842 | 284,960 | 94,207 | 339,340 |
| 3.06.01.01 | Financial Income | 109,762 | 297,251 | 98,684 | 356,354 |
| 3.06.01.02 | Exchange Gains | 0 | 347 | 112 | 223 |
| 3.06.01.03 | COFINS and PASEP | -3,920 | -12,638 | -4,589 | -17,237 |
| 3.06.02 | Financial Expenses | 117,027 | -339,509 | -271,017 | 196,730 |
| 3.06.02.01 | Financial Expenses | -136,131 | -469,978 | -191,812 | -668,146 |
| 3.06.02.02 | Exchange Losses | 253,158 | 130,469 | -79,205 | 864,876 |
| 3.07 | Earnings before Income Tax | 1,369,324 | 2,883,881 | 886,779 | 3,067,389 |
| 3.08 | Income Tax and Social Contribution | -468,799 | -977,186 | -312,892 | -1,067,182 |

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Parent Company's Financial Statements / Income Statement (R\$ thousand)

(R\$ thousand)

| Code | Description | Current Quarter 7/01/2017 to 9/30/2017 | YTD Current Year 1/01/2017 to 9/30/2017 | Same Quarter Previous Year 7/01/2016 to 9/30/2016 | YTD Previous Year 1/01/2016 to 9/30/2016 |
|------------|--------------------------------------|---|--|--|---|
| 3.08.01 | Current | -406,548 | -899,391 | -243,481 | -994,684 |
| 3.08.02 | Deferred | -62,251 | -77,795 | -69,411 | -72,498 |
| 3.09 | Net Result from Continued Operations | 900,525 | 1,906,695 | 573,887 | 2,000,207 |
| 3.11 | Profit/Loss for the Period | 900,525 | 1,906,695 | 573,887 | 2,000,207 |
| 3.99 | Earnings per Share - (Reais/Share) | | | | |
| 3.99.01 | Basic Earnings per Share | | | | |
| 3.99.01.01 | Common Share | 1.31750 | 2.78957 | 0.83962 | 2.92638 |
| 3.99.02 | Diluted Earnings per Share | | | | |
| 3.99.02.01 | Common Share | 1.31750 | 2.78957 | 0.83962 | 2.92638 |

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Parent Company's Financial Statements / Income Statement (R\$ thousand)

(R\$ thousand)

| Code | Description | Current Quarter 7/01/2017 to 9/30/2017 | YTD Current Year 1/01/2017 to 9/30/2017 | Same Quarter Previous Year 7/01/2016 to 9/30/2016 | YTD Previous Year 1/01/2016 to 9/30/2016 |
|---------|---|---|--|--|---|
| 4.01 | Net Income for the Period | 900,525 | 1,906,695 | 573,887 | 2,000,207 |
| 4.02 | Other Comprehensive Income | 0 | 0 | -181,073 | -181,073 |
| | Actuarial Gains and (Losses) on Defined Benefit | | | | |
| 4.02.01 | Pension Plans | 0 | 0 | -181,073 | -181,073 |
| 4.03 | Comprehensive Income for the Period | 900,525 | 1,906,695 | 392,814 | 1,819,134 |

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Parent Company's Financial Statements / Statement of Comprehensive Income (R\$ thousand)

(R\$ thousand)

| Code | Description | YTD Current Year 1/01/2017 to 9/30/2017 | YTD Previous Year 1/01/2016 to 9/30/2016 |
|------|------------------------------------|--|--|
| 6.01 | Net Cash from Operating Activities | 2,339,196 | 2,028,835 |

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| | | | |
|------------|--|------------|------------|
| 6.01.01 | Cash from Operations | 4,659,239 | 3,562,907 |
| 6.01.01.01 | Profit (loss) before Income Tax and Social Contribution | 2,883,881 | 3,067,389 |
| 6.01.01.02 | Provision and Inflation Adjustments on Provisions | 138,571 | 207,313 |
| 6.01.01.03 | Pension Plan Liabilities – Early Reduction (Curtailment) | 0 | -334,152 |
| 6.01.01.04 | Finance Charges from Customers | -169,194 | -158,219 |
| 6.01.01.05 | Residual Value of Property, Plant and Equipment, Intangible Assets and Investment Properties Written-off | 11,528 | 7,211 |
| 6.01.01.06 | Depreciation and Amortization | 974,487 | 859,055 |
| 6.01.01.07 | Interest on Borrowings and Financing Payable | 296,665 | 352,665 |
| 6.01.01.08 | Monetary and Exchange Change on Borrowings and Financing | -86,081 | -754,853 |
| 6.01.01.09 | Interest and Monetary Changes on Liabilities | 6,948 | 21,434 |
| 6.01.01.10 | Interest and Monetary Changes on Assets | -28,710 | -69,272 |
| 6.01.01.11 | Allowance for Doubtful Accounts | 87,480 | 110,181 |
| 6.01.01.12 | Provision for Consent Decree (TAC) | 60,670 | 12,229 |
| 6.01.01.13 | Equity Results | -4,699 | -2,278 |
| 6.01.01.14 | Provision for Sabesprev Mais | 0 | 235 |
| 6.01.01.15 | Other Adjustments | -10,332 | -6,466 |
| 6.01.01.16 | Transfer of Funds to São Paulo Municipal Government | 318,920 | 19,089 |
| 6.01.01.17 | Construction Margin over Intangible Assets Resulting from Concession Contracts | -49,299 | -57,006 |
| 6.01.01.18 | Pension Plan Liabilities | 228,404 | 288,352 |
| 6.01.02 | Changes in Assets and Liabilities | -1,040,984 | -173,827 |
| 6.01.02.01 | Trade Receivables | 49,471 | -28,316 |
| 6.01.02.02 | Related-Party Balances and Transactions | 68,390 | -3,597 |
| 6.01.02.03 | Inventories | -65,200 | 13,385 |
| 6.01.02.04 | Recoverable Taxes | 31,586 | 65,244 |
| 6.01.02.05 | Other Receivables | -56,751 | 88,705 |
| 6.01.02.06 | Escrow Deposits | -17,678 | 31,740 |
| 6.01.02.08 | Contractors and Suppliers | -217,200 | -9,720 |
| 6.01.02.09 | Payroll, Provisions and Social Contribution | 79,361 | 59,815 |
| 6.01.02.10 | Pension Plan Liabilities | -160,699 | -134,274 |
| 6.01.02.11 | Taxes and Contributions Payable | -151,611 | -106,825 |
| 6.01.02.12 | Services Payable | -392,765 | -27,537 |
| 6.01.02.13 | Other Liabilities | 7,805 | 5,144 |
| 6.01.02.14 | Provisions | -209,865 | -131,711 |
| 6.01.02.15 | Deferred Cofins/Pasep | -5,828 | 4,120 |
| 6.01.03 | Other | -1,279,059 | -1,360,245 |

| | | | |
|------------|--|------------|------------|
| 6.01.03.01 | Interest Paid | -494,094 | -535,299 |
| 6.01.03.02 | Income Tax and Social Contribution Paid | -784,965 | -824,946 |
| 6.02 | Net Cash from Investing Activities | -1,237,362 | -1,444,922 |
| 6.02.01 | Acquisition of Intangible Assets | -1,233,769 | -1,432,336 |
| 6.02.02 | Acquisition of Property, Plant and Equipment | -12,442 | -23,313 |

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 ESTADO SÃO PAULO

Parent Company's Financial Statements / Statement of Cash Flows – Indirect Method (R\$ thousand)

(R\$ thousand)

| Code | Description | YTD Current Year 1/01/2017 to 9/30/2017 | YTD Previous Year 1/01/2016 to 9/30/2016 |
|---------|--|--|--|
| 6.02.04 | Restricted Cash | 8,849 | 10,727 |
| 6.03 | Net Cash from Financing Activities | -887,055 | -807,662 |
| 6.03.01 | Funding | 893,178 | 493,863 |
| 6.03.02 | Amortization | -953,482 | -968,124 |
| 6.03.03 | Payment of Interest on Equity | -765,933 | -139,399 |
| 6.03.04 | Public-Private Partnership - PPP | -23,528 | -22,865 |
| 6.03.05 | Program Contract Commitments | -37,290 | -171,137 |
| 6.05 | Increase (Decrease) in Cash and Cash Equivalents | 214,779 | -223,749 |
| 6.05.01 | Opening Cash and Cash Equivalents | 1,886,221 | 1,639,214 |
| 6.05.02 | Closing Cash and Cash Equivalents | 2,101,000 | 1,415,465 |

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ESTADO SÃO PAULO

Version : 1

Parent Company's Financial Statements / Statement of Changes in Equity / 1/01/2017 to 9/30/2017 (R\$ thousand)

(R\$ thousand)

| Code | Description | Paid-up Capital | Capital Reserves, Options Granted and Treasury Shares | Profit Reserves | Earnings/Accumulated Losses | Retained Comprehensive Income | Other Income | Equity |
|---------|--|--------------------|---|--------------------|--------------------------------|-------------------------------------|-----------------|------------|
| 5.01 | Opening Balances | 10,000,000 | 0 | 6,244,859 | 0 | -825,648 | | 15,419,211 |
| 5.03 | Restated Opening Balances | 10,000,000 | 0 | 6,244,859 | 0 | -825,648 | | 15,419,211 |
| 5.04 | Capital Transactions with Partners | 0 | 0 | -62,719 | 0 | 0 | | -62,719 |
| 5.04.08 | Additional Dividends Approved | 0 | 0 | -62,719 | 0 | 0 | | -62,719 |
| 5.05 | Total Comprehensive Income | 0 | 0 | 0 | 1,906,695 | 0 | | 1,906,695 |
| 5.05.01 | Net Income for the Period | 0 | 0 | 0 | 1,906,695 | 0 | | 1,906,695 |

Parent Company's Financial Statements / Statement of Changes in Equity / 1/01/2017 to 9/30/2017 (R\$ thousand)

| | | | | | | | |
|------|---------------------|------------|---|-----------|-----------|----------|------------|
| 5.07 | Closing Balances | 10,000,000 | 0 | 6,182,140 | 1,906,695 | -825,648 | 17,263,187 |
|------|---------------------|------------|---|-----------|-----------|----------|------------|

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**Parent Company's Financial Statements / Statement of Changes in Equity / 1/01/2016 to 9/30/2016
(R\$ thousand)**

(R\$ thousand)

| Code | Description | Paid-up Capital | Capital Reserves, Options Granted and Treasury Shares | Profit Reserves | Earnings/Accumulated Losses | Retained Comprehensive Income | Other Income | Eq |
|------------|--|--------------------|---|----------------------------|--------------------------------|-------------------------------------|-----------------|---------|
| 5.01 | Opening Balances | 10,000,000 | 0 | 4,069,988 | | 0 | -353,382 | 13,716, |
| 5.03 | Restated Opening Balances | 10,000,000 | 0 | 4,069,988 | | 0 | -353,382 | 13,716, |
| 5.04 | Capital Transactions with Partners | 0 | 0 | -11,453 | | 0 | 0 | -11, |
| 5.04.08 | Additional Dividends Approved | 0 | 0 | -11,453 | | 0 | 0 | -11, |
| 5.05 | Total Comprehensive Income | 0 | 0 | 0 | | 2,000,207 | -181,073 | 1,819, |
| 5.05.01 | Net Income for the Period | 0 | 0 | 0 | | 2,000,207 | 0 | 2,000, |
| 5.05.02 | Other Comprehensive Income | 0 | 0 | 0 | | 0 | -181,073 | -181, |
| 5.05.02.06 | Actuarial Gains and Losses | 0 | 0 | 0 | | 0 | -181,073 | -181, |
| 5.07 | Closing Balances | 10,000,000 | 0 | 4,058,535 | | 2,000,207 | -534,455 | 15,524, |

Parent Company's Financial Statements / Statement of Changes in Equity / 1/01/2017 to 9/30/2017 (R\$ thousand)

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Parent Company's Financial Statements / Statement of Value Added (R\$ thousand)

| Code | Description | YTD Current Year 1/01/2017 to 9/30/2017 | YTD Previous Year 1/01/2016 to 9/30/2016 |
|------------|--|--|--|
| 7.01 | Revenue | 11,115,257 | 10,711,651 |
| 7.01.01 | Goods, Products and Services Sold | 8,930,628 | 8,148,172 |
| 7.01.02 | Other Revenue | 56,884 | 53,421 |
| 7.01.03 | Revenue from Construction of own Assets | 2,215,225 | 2,620,239 |
| 7.01.04 | Allowance for/Reversal of Doubtful Accounts | -87,480 | -110,181 |
| 7.02 | Inputs Acquired from Third Parties | -3,921,047 | -4,445,400 |
| 7.02.01 | Costs of Sales and Services | -3,259,707 | -3,801,316 |
| 7.02.02 | Materials, Electricity, Outside Services and Others | -652,920 | -629,592 |
| 7.02.04 | Other | -8,420 | -14,492 |
| 7.03 | Gross Value Added | 7,194,210 | 6,266,251 |
| 7.04 | Retentions | -974,487 | -859,055 |
| 7.04.01 | Depreciation, Amortization and Depletion | -974,487 | -859,055 |
| 7.05 | Net Value Added Produced | 6,219,723 | 5,407,196 |
| 7.06 | Wealth Received in Transfer | 302,297 | 358,855 |
| 7.06.01 | Equity Results | 4,699 | 2,278 |
| 7.06.02 | Financial Income | 297,598 | 356,577 |
| 7.07 | Total Value Added to Distribute | 6,522,020 | 5,766,051 |
| 7.08 | Value Added Distribution | 6,522,020 | 5,766,051 |
| 7.08.01 | Personnel | 1,779,458 | 1,351,586 |
| 7.08.01.01 | Salaries and Wages | 1,160,465 | 1,069,596 |
| 7.08.01.02 | Benefits | 457,107 | 187,243 |
| 7.08.01.03 | Government Severance Indemnity Fund for Employees (FGTS) | 161,886 | 94,747 |
| 7.08.02 | Taxes and Contributions | 1,964,668 | 2,045,460 |
| 7.08.02.01 | Federal | 1,859,833 | 1,954,985 |
| 7.08.02.02 | State | 73,653 | 61,118 |
| 7.08.02.03 | Municipal | 31,182 | 29,357 |
| 7.08.03 | Value Distributed to Providers of Capital | 871,199 | 368,798 |
| 7.08.03.01 | Interest | 816,233 | 299,777 |
| 7.08.03.02 | Rental | 54,966 | 69,021 |
| 7.08.04 | Value Distributed to Shareholders | 1,906,695 | 2,000,207 |
| 7.08.04.03 | Retained Earnings/Accumulated Loss for the Period | 1,906,695 | 2,000,207 |

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Comments on the Company's Performance**1. Financial highlights**

R\$ million

| | 3Q17 | 3Q16 | Chg. (R\$) | | 9M17 | 9M16 | Chg. (R\$) | |
|---|-----------|-----------|------------|---------|-----------|-----------|------------|---------|
| | | | R\$ | % | | | R\$ | % |
| Gross operating revenue | 2,999.7 | 2,854.1 | 145.6 | 5.1 | 8,930.6 | 8,148.2 | 782.4 | 9.6 |
| Construction revenue | 712.9 | 1,097.8 | (384.9) | (35.1) | 2,215.2 | 2,620.2 | (405.0) | (15.5) |
| COFINS and PASEP taxes | (176.1) | (206.1) | 30.0 | (14.6) | (555.9) | (556.2) | 0.3 | (0.1) |
| (=) Net operating revenue | 3,536.5 | 3,745.8 | (209.3) | (5.6) | 10,589.9 | 10,212.2 | 377.7 | 3.7 |
| Costs and expenses | (1,711.4) | (1,615.5) | (95.9) | 5.9 | (5,528.0) | (5,147.9) | (380.1) | 7.4 |
| Construction costs | (694.5) | (1,073.5) | 379.0 | (35.3) | (2,165.9) | (2,563.2) | 397.3 | (15.5) |
| Equity result | 1.2 | 0.5 | 0.7 | 140.0 | 4.7 | 2.3 | 2.4 | 104.3 |
| Other operating revenue (expenses), net | 14.6 | 6.3 | 8.3 | 131.7 | 37.7 | 27.9 | 9.8 | 35.1 |
| (=) Earnings before financial result, income tax and social contribution | 1,146.4 | 1,063.6 | 82.8 | 7.8 | 2,938.4 | 2,531.3 | 407.1 | 16.1 |
| Financial result | 222.9 | (176.8) | 399.7 | (226.1) | (54.5) | 536.1 | (590.6) | (110.2) |
| (=) Earnings before income tax and social contribution | 1,369.3 | 886.8 | 482.5 | 54.4 | 2,883.9 | 3,067.4 | (183.5) | (6.0) |
| Income tax and social contribution | (468.8) | (312.9) | (155.9) | 49.8 | (977.2) | (1,067.2) | 90.0 | (8.4) |
| (=) Net income | 900.5 | 573.9 | 326.6 | 56.9 | 1,906.7 | 2,000.2 | (93.5) | (4.7) |
| Earnings per share (R\$)* | 1.32 | 0.84 | | | 2.79 | 2.93 | | |

* Total shares = 683,509,869

Adjusted EBITDA Reconciliation (Non-accounting measures)*R\$ million*

Adjusted EBITDA Reconciliation (Non-accounting measures)

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| | Chg. (R\$) | | | | Chg. (R\$) | | | |
|---|------------|---------|---------|---------|------------|---------|--------|---------|
| | 3Q17 | 3Q16 | R\$ | % | 9M17 | 9M16 | R\$ | % |
| Net income | 900.5 | 573.9 | 326.6 | 56.9 | 1,906.7 | 2,000.2 | (93.5) | (4.7) |
| Income tax and social contribution | 468.8 | 312.9 | 155.9 | 49.8 | 977.2 | 1,067.2 | (90.0) | (8.4) |
| Financial result | (222.9) | 176.8 | (399.7) | (226.1) | 54.5 | (536.1) | 590.6 | (110.2) |
| Other operating revenue (expenses), net | (14.6) | (6.3) | (8.3) | 131.7 | (37.7) | (27.9) | (9.8) | 35.1 |
| (=) Adjusted EBIT* | 1,131.8 | 1,057.3 | 74.5 | 7.0 | 2,900.7 | 2,503.4 | 397.3 | 15.9 |
| Depreciation and amortization | 324.5 | 280.2 | 44.3 | 15.8 | 974.5 | 859.1 | 115.4 | 13.4 |
| (=) Adjusted EBITDA ** | 1,456.3 | 1,337.5 | 118.8 | 8.9 | 3,875.2 | 3,362.5 | 512.7 | 15.2 |
| (%) Adjusted EBITDA margin | 41.2 | 35.7 | | | 36.6 | 32.9 | | |

(*) Adjusted EBIT is net income before: (i) other operating revenues/expenses, net; (ii) financial result; and (iii) income tax and social contribution.

(**) Adjusted EBITDA is net income before: (i) depreciation and amortization expenses; (ii) income tax and social contribution;

(iii) financial result; and (iv) other operating revenues/expenses, net.

In 3Q17, net operating revenue, including construction revenue, reached R\$ 3,536.5 million; a 5.6% decrease compared to the same period in 2016.

Costs and expenses, including construction costs, totaled R\$ 2,405.9 million, 10.5% lower than in 3Q16.

Adjusted EBIT, in the amount of R\$ 1,131.8 million, increased 7.0% from R\$ 1,057.3 million recorded in 3Q16.

Adjusted EBITDA, in the amount of R\$ 1,456.3 million, increased 8.9% from R\$ 1,337.5 million recorded in 3Q16.

(R\$ 5,084.3 million in the last twelve months).

The adjusted EBITDA margin was 41.2% in 3Q17 against 35.7% in 3Q16 (35.1% in the last twelve months).

Excluding construction revenues and construction costs, the adjusted EBITDA margin was 50.9% in 3Q17 (49.6% in 3Q16 and 44.9% in the last twelve months).

In 3Q17 the Company recorded a net income of R\$ 900.5 million, in comparison to a net income of R\$ 573.9 million in 3Q16.

2. Gross operating revenue

Gross operating revenue from sanitation services, not including construction revenue, totaled R\$ 2,999.7 million, an increase of R\$ 145.6 million or 5.1%, when compared to the R\$ 2,854.1 million recorded in 3Q16.

The main factors that led to this variation were:

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- Increase of 4.8% in the Company's total billed volume (5.0% in water and 4.6% in sewage); and
- Lower estimated loss of wholesale revenue in 3Q17, in the amount of R\$ 16.7 million, due to the payment received in the period, especially from the Guarulhos municipal government.

3. Construction revenue

Construction revenue decreased R\$ 384.9 million or 35.1%, when compared to 3Q16. The variation was mainly due to lower investments in the municipalities served by the Company.

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4. Billed volume

The following tables show the water and sewage billed volume, on quarter-on-quarter and year-to-date basis, per customer category and region.

WATER AND SEWAGE BILLED VOLUME(1) PER CUSTOMER CATEGORY – million m3

| Category | QUARTER | | | | | | | | |
|---------------------|--------------|--------------|------------|--------------|--------------|------------|----------------|--------------|------------|
| | Water | | | Sewage | | | Water + Sewage | | |
| | 3Q17 | 3Q16 | % Chg.3Q17 | 3Q17 | 3Q16 | % Chg.3Q17 | 3Q17 | 3Q16 | % Chg. |
| Residential | 394.2 | 377.6 | 4.4 | 336.3 | 321.0 | 4.8 | 730.5 | 698.6 | 4.6 |
| Commercial | 41.6 | 40.3 | 3.2 | 40.1 | 38.5 | 4.2 | 81.7 | 78.8 | 3.7 |
| Industrial | 7.8 | 8.0 | (2.5) | 9.4 | 9.5 | (1.1) | 17.2 | 17.5 | (1.7) |
| Public | 10.2 | 10.2 | - | 9.2 | 9.0 | 2.2 | 19.4 | 19.2 | 1.0 |
| Total retail | 453.8 | 436.1 | 4.1 | 395.0 | 378.0 | 4.5 | 848.8 | 814.1 | 4.3 |
| Wholesale (3) | 65.4 | 58.4 | 12.0 | 8.6 | 7.9 | 8.9 | 74.0 | 66.3 | 11.6 |
| Total | 519.2 | 494.5 | 5.0 | 403.6 | 385.9 | 4.6 | 922.8 | 880.4 | 4.8 |

JANUARY TO SEPTEMBER

| Category | QUARTER | | | | | | | | |
|---------------------|----------------|----------------|------------|----------------|----------------|------------|----------------|----------------|------------|
| | Water | | | Sewage | | | Water + Sewage | | |
| | 9M17 | 9M16 | % Chg.9M17 | 9M17 | 9M16 | % Chg.9M17 | 9M17 | 9M16 | % Chg. |
| Residential | 1,177.9 | 1,135.6 | 3.7 | 1,002.7 | 961.4 | 4.3 | 2,180.6 | 2,097.0 | 4.0 |
| Commercial | 123.9 | 121.7 | 1.8 | 118.9 | 115.7 | 2.8 | 242.8 | 237.4 | 2.3 |
| Industrial | 23.6 | 23.7 | (0.4) | 28.1 | 28.8 | (2.4) | 51.7 | 52.5 | (1.5) |
| Public | 30.6 | 30.5 | 0.3 | 27.1 | 26.8 | 1.1 | 57.7 | 57.3 | 0.7 |
| Total retail | 1,356.0 | 1,311.5 | 3.4 | 1,176.8 | 1,132.7 | 3.9 | 2,532.8 | 2,444.2 | 3.6 |
| Wholesale (3) | 191.6 | 167.1 | 14.7 | 26.5 | 21.1 | 25.6 | 218.1 | 188.2 | 15.9 |
| Total | 1,547.6 | 1,478.6 | 4.7 | 1,203.3 | 1,153.8 | 4.3 | 2,750.9 | 2,632.4 | 4.5 |

WATER AND SEWAGE BILLED VOLUME (1) PER REGION - million m3

| Region | QUARTER | | | | | | | | |
|---------------------|--------------|--------------|------------|--------------|--------------|------------|----------------|--------------|------------|
| | Water | | | Sewage | | | Water + Sewage | | |
| | 3Q17 | 3Q16 | % Chg.3Q17 | 3Q17 | 3Q16 | % Chg.3Q17 | 3Q17 | 3Q16 | % Chg. |
| Metropolitan | 295.1 | 283.5 | 4.1 | 257.6 | 246.8 | 4.4 | 552.7 | 530.3 | 4.2 |
| Regional (2) | 158.7 | 152.6 | 4.0 | 137.4 | 131.2 | 4.7 | 296.1 | 283.8 | 4.3 |
| Total retail | 453.8 | 436.1 | 4.1 | 395.0 | 378.0 | 4.5 | 848.8 | 814.1 | 4.3 |
| Wholesale (3) | 65.4 | 58.4 | 12.0 | 8.6 | 7.9 | 8.9 | 74.0 | 66.3 | 11.6 |
| Total | 519.2 | 494.5 | 5.0 | 403.6 | 385.9 | 4.6 | 922.8 | 880.4 | 4.8 |

JANUARY TO SEPTEMBER

| Water | Sewage | Water + Sewage |
|-------|--------|----------------|
|-------|--------|----------------|

| Region | 9M17 | 9M16 | % Chg. | 9M17 | 9M16 | % Chg. | 9M17 | 9M16 | % Chg. |
|---------------------|----------------|----------------|---------------|----------------|----------------|---------------|----------------|----------------|---------------|
| Metropolitan | 877.5 | 846.0 | 3.7 | 763.9 | 735.1 | 3.9 | 1,641.4 | 1,581.1 | 3.8 |
| Regional (2) | 478.5 | 465.5 | 2.8 | 412.9 | 397.6 | 3.8 | 891.4 | 863.1 | 3.3 |
| Total retail | 1,356.0 | 1,311.5 | 3.4 | 1,176.8 | 1,132.7 | 3.9 | 2,532.8 | 2,444.2 | 3.6 |
| Wholesale (3) | 191.6 | 167.1 | 14.7 | 26.5 | 21.1 | 25.6 | 218.1 | 188.2 | 15.9 |
| Total | 1,547.6 | 1,478.6 | 4.7 | 1,203.3 | 1,153.8 | 4.3 | 2,750.9 | 2,632.4 | 4.5 |

(1) Unaudited

(2) Including coastal and interior region

(3) Reused water volume and non-domestic sewage are included in

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5. Costs, administrative & selling expenses and construction costs

Costs, administrative & selling expenses as well as construction costs decreased 10.5% in 3Q17 (R\$ 283.1 million). Excluding construction costs, costs and expenses increased by 5.9% (R\$ 95.9 million).

As a percentage of net revenue, costs and expenses were 68.0% in 3Q17 compared to 71.8% in 3Q16.

| | <i>R\$ million</i> | | | | | | | |
|---|--------------------|----------------|----------------|---------------|----------------|----------------|---------------|--------------|
| | 3Q17 | 3Q16 | Chg. R\$ | % | 9M17 | 9M16 | Chg. R\$ | % |
| Salaries and payroll charges and Pension plan obligations | 623.4 | 292.3 | 331.1 | 113.3 | 1,927.8 | 1,488.0 | 439.8 | 29.6 |
| General supplies | 39.8 | 45.6 | (5.8) | (12.7) | 117.4 | 124.5 | (7.1) | (5.7) |
| Treatment supplies | 60.1 | 64.0 | (3.9) | (6.1) | 198.9 | 205.3 | (6.4) | (3.1) |
| Services | 288.4 | 347.1 | (58.7) | (16.9) | 920.9 | 945.8 | (24.9) | (2.6) |
| Electricity | 203.6 | 224.7 | (21.1) | (9.4) | 591.2 | 707.9 | (116.7) | (16.5) |
| General expenses | 184.4 | 249.3 | (64.9) | (26.0) | 633.9 | 640.6 | (6.7) | (1.0) |
| Tax expenses | 21.6 | 22.6 | (1.0) | (4.4) | 75.9 | 66.5 | 9.4 | 14.1 |
| Sub-total | 1,421.3 | 1,245.6 | 175.7 | 14.1 | 4,466.0 | 4,178.6 | 287.4 | 6.9 |
| Depreciation and amortization | 324.5 | 280.2 | 44.3 | 15.8 | 974.5 | 859.1 | 115.4 | 13.4 |
| Allowance for doubtful accounts | (34.4) | 89.7 | (124.1) | (138.4) | 87.5 | 110.2 | (22.7) | (20.6) |
| Sub-total | 290.1 | 369.9 | (79.8) | (21.6) | 1,062.0 | 969.3 | 92.7 | 9.6 |
| Costs, administrative and selling expenses | 1,711.4 | 1,615.5 | 95.9 | 5.9 | 5,528.0 | 5,147.9 | 380.1 | 7.4 |
| Construction costs | 694.5 | 1,073.5 | (379.0) | (35.3) | 2,165.9 | 2,563.2 | (397.3) | (15.5) |
| Costs, adm & selling expenses and construction costs | 2,405.9 | 2,689.0 | (283.1) | (10.5) | 7,693.9 | 7,711.1 | (17.2) | (0.2) |
| % of net revenue | 68.0 | 71.8 | | | 72.7 | 75.5 | | |

5.1. Salaries and payroll charges and Pension plan obligations

There was an increase of R\$ 331.1 million in 3Q17, mainly due to:

- Increase of R\$ 34.5 million, mostly due to the 1% increase related to the Career and Salary Plan since December 2016 and the 3.71% pay rise in May 2017; and
- Migration of 3,572 participants from the Defined Benefit Plan (G1) to the Defined Contribution Plan (Sabesprev Mais) in 3Q16, generating an early reduction of R\$ 334.2 million in the actuarial deficit, offset by an incentive and extraordinary contribution of R\$ 26.8 million, resulting in a net reduction of R\$ 307.4 million in expenses in that period.

5.2. Services

Services expenses totaled R\$ 288.4 million, R\$ 58.7 million less than the R\$ 347.1 million recorded in 3Q16. This decline was distributed in several items, including:

- Marketing campaigns, in the amount of R\$ 10.9 million;
- Nautical services related to the application of chemicals in the water reservoirs, in the amount of R\$ 10.1 million;
- Leasing of machinery and equipment, in the amount of R\$ 4.3 million; and
- Telephony, in the amount of R\$ 3.2 million.

5.3. Electricity

Electricity expenses totaled R\$ 203.6 million in 3Q17, a decrease of R\$ 21.1 million or 9.4% in comparison to the R\$ 224.7 million in 3Q16. The main factors that contributed to this decrease were:

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- Average reduction of 12.1% in the free market tariffs, with an 14.6% increase in consumption;
- Average reduction of 29.4% in the grid market tariff (TUSD), with a 19.6% rise in consumption; and
- Average reduction of 3.0% in the regulated market tariffs, with a 3.0%.decrease in consumption.

In 3Q17, the free market accounted for 35.2% of the total electricity consumed by the Company, the grid market accounted for 31.9% and the regulated market accounted for 32.9% of total consumption.

5.4. General expenses

General expenses decreased R\$ 64.9 million, or 26.0%, totaling R\$ 184.4 million in 3Q17, versus the R\$ 249.3 million recorded in 3Q16, mainly due to the following reasons:

- Higher provisioning for lawsuits in 3Q16, totaling R\$ 31.6 million; and
- Non-recurring provisioning of R\$ 38.1 million in 3Q16, related to the agreement with Empresa Metropolitana de Águas e Energia – EMAE.

5.5. Depreciation and amortization

Depreciation and amortization increased R\$ 44.3 million or 15.8%, reaching R\$ 324.5 million in 3Q17 in comparison to the R\$ 280.2 million recorded in 3Q16, largely due to the beginning of operations of intangible assets, in the amount of R\$ 1.6 billion.

5.6. Allowance for doubtful accounts

The allowance for doubtful accounts fell R\$ 124.1 million, mainly due to lower default rates in the period.

6. Other operating revenue (expenses), net

There was an R\$ 8.3 million increase in this line, mostly due to the payment of R\$ 9.2 million received under the Water Basin Clean up Program.

7. Financial result

| | 3Q17 | 3Q16 | | <i>R\$ million</i> | |
|-------------------------------------|------|--------------|----------------|--------------------|----------------|
| | | | | Chg. | % |
| Financial expenses, net of income | | (44.5) | (91.7) | 47.2 | (51.5) |
| Net monetary and exchange variation | | 267.4 | (85.1) | 352.5 | (414.2) |
| Financial Result | | 222.9 | (176.8) | 399.7 | (226.1) |

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7.1. Financial income and expenses

| | 3Q17 | 3Q16 | Chg. | <i>R\$ million</i> % |
|---|----------------|----------------|-------------|-------------------------|
| Financial expenses | | | | |
| Interest and charges on international loans and financing | (28.7) | (28.5) | (0.2) | 0.7 |
| Interest and charges on domestic loans and financing | (72.4) | (80.5) | 8.1 | (10.1) |
| Other financial expenses | (30.6) | (49.2) | 18.6 | (37.8) |
| Total financial expenses | (131.7) | (158.2) | 26.5 | (16.8) |
| Financial income | 87.2 | 66.5 | 20.7 | 31.1 |
| Financial expenses, net of income | (44.5) | (91.7) | 47.2 | (51.5) |

7.1.1. Financial expenses

Decrease of R\$ 26.5 million, mainly due to the following events:

- Interest and charges on domestic loans and financing: decline of R\$ 8.1 million, mainly due to the lower CDI rate in 3Q17, compared with 3Q16 (8.14% and 14.13%, respectively); and
- Other financial expenses: reduction of R\$ 18.6 million, mostly due to lower provisioning for interest on court proceedings in 3Q17.

7.1.2. Financial income

Financial income moved up R\$ 20.7 million, mostly due to the higher recognition of interest on installment agreements in 3Q17.

7.2. Monetary and exchange rate variation on assets and liabilities

| | 3Q17 | 3Q16 | <i>R\$ million</i> | |
|--|--------------|----------------|--------------------|----------------|
| | | | Chg. | % |
| Monetary variation on loans and financing | (3.6) | (24.4) | 20.8 | (85.2) |
| Currency exchange variation on loans and financing | 253.2 | (79.2) | 332.4 | (419.7) |
| Other monetary variations | (0.9) | (9.1) | 8.2 | (90.1) |
| Monetary/exchange rate variation on liabilities | 248.7 | (112.7) | 361.4 | (320.7) |
| Monetary/Exchange rate variation on assets | 18.7 | 27.6 | (8.9) | (32.2) |
| Monetary/exchange rate variation, net | 267.4 | (85.1) | 352.5 | (414.2) |

7.2.1. Monetary and exchange rate variation on liabilities

The effect of monetary and currency variations in 3Q17 was R\$ 361.4 million lower than in 3Q16, mainly due to:

- Reduction of R\$ 20.8 million in expenses with monetary variation on loans and financing, due to the lower variation in the IPCA in 3Q17 compared with 3Q16 (0.6% and 1.0%, respectively); and;
- Decrease of R\$ 332.4 million in exchange variation on loans and financing, as a result of the devaluation of dollar and yen against the real in 3Q17 (-4.2% and -4.5%, respectively), versus an appreciation of 1.1% and 2.7%, respectively, in 3Q16).

8. Income tax and social contribution

Increase of R\$ 155.9 million, mainly due to the higher taxable result reported in the period, which was mostly impacted by the devaluation of dollar and yen against the real in 3Q17, versus an appreciation in 3Q16.

9. Indicators

9.1. Operating

| Operating indicators(*) | 3Q17 | 3Q16 | % |
|---|--------|--------|-------|
| Water connections(1) | 8,807 | 8,595 | 2.5 |
| Sewage connections (1) | 7,247 | 7,036 | 3 |
| Population directly served - water (2) | 24.9 | 24.6 | 1.2 |
| Population directly served - sewage (2) | 21.5 | 21.1 | 1.9 |
| Number of employees | 13,901 | 14,172 | (1.9) |
| Water volume produced - quarter (3) | 695 | 670 | 3.8 |
| Water volume produced in 9M (3) | 2,082 | 2,006 | 3.8 |
| IPM - Measured water loss (%) | 31.1 | 31.3 | (0.6) |
| IPDt (liters/connection x day) | 306 | 298 | 2.7 |

(1) Total connections, active and inactive, in thousand units at the end of the period

(2) In million inhabitants, at the end of the period. Not including wholesale

(3) In millions of cubic meters

(*) Unaudited

9.2. Financial

| Economic Variables at the close of the quarter(*) | 3Q17 | 3Q16 |
|---|---------|---------|
| Amplified Consumer Price Index Variation (%) ⁽¹⁾ | 0.59 | 1.04 |
| Referential Rate Variation (%) ⁽¹⁾ | 0.1132 | 0.5752 |
| Interbank Deposit Certificate (%) ⁽²⁾ | 8.14 | 14.13 |
| US DOLLAR ⁽³⁾ | 3.1680 | 3.2462 |
| YEN ⁽³⁾ | 0.02813 | 0.03207 |

(1) Quarterly rate

(2) Last day average

(3) R\$/previous day price

(*) Unaudited

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10. Loans and financing

R\$ million

| INSTITUTION | DEBT PROFILE | | | | | | | Total |
|----------------------------------|--------------|----------------|----------------|----------------|--------------|--------------|----------------|-----------------|
| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 onwards | |
| Local Currency | | | | | | | | |
| Brazilian Federal Savings Bank | 15.9 | 66.9 | 69.1 | 71.5 | 75.2 | 79.2 | 838.4 | 1,216.2 |
| Debentures | 58.7 | 897.8 | 1,015.7 | 573.2 | 374.6 | 353.8 | 255.9 | 3,529.7 |
| BNDES | 22.1 | 98.3 | 112.3 | 94.2 | 93.8 | 93.8 | 538.1 | 1,052.6 |
| Leasing | 4.2 | 30.3 | 31.8 | 33.4 | 35.1 | 37.0 | 387.2 | 559.0 |
| Others | 0.2 | 1.5 | 1.4 | 1.4 | 1.4 | 1.3 | 4.0 | 11.2 |
| Interest and other charges | 50.3 | 64.8 | - | - | - | - | - | 115.1 |
| Total Local Currency | 151.4 | 1,159.6 | 1,230.3 | 773.7 | 580.1 | 565.1 | 2,023.6 | 6,483.8 |
| Foreign Currency | | | | | | | | |
| IADB | 39.8 | 107.4 | 107.4 | 107.4 | 107.4 | 107.4 | 1,056.4 | 1,633.2 |
| IBRD | - | - | 9.6 | 19.3 | 19.3 | 19.3 | 221.4 | 288.9 |
| Deutsche Bank 350 | - | 237.6 | 230.9 | - | - | - | - | 468.5 |
| Eurobond | - | - | - | 1,106.1 | - | - | - | 1,106.1 |
| JICA | 1.2 | 64.0 | 108.8 | 108.8 | 108.8 | 108.8 | 1,108.6 | 1,609.0 |
| BID 1983AB | - | 75.6 | 56.0 | 54.6 | 24.4 | 24.4 | 22.4 | 257.4 |
| Interest and other charges | 36.0 | 4.8 | - | - | - | - | - | 40.8 |
| Total in foreign currency | 77.0 | 489.4 | 512.7 | 1,396.2 | 259.9 | 259.9 | 2,408.8 | 5,403.9 |
| Total | 228.4 | 1,649.0 | 1,743.0 | 2,169.9 | 840.0 | 825.0 | 4,432.4 | 11,887.7 |

11. Capex

In 9M17, capex reached R\$ 2.3 billion, including R\$ 0.6 billion related to the São Lourenço PPP. Out of the total amount invested by the Company, R\$ 1.1 billion has not affected the Company's cash.

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1 Operations

Companhia de Saneamento Básico do Estado de São Paulo ("SABESP" or the "Company") is a mixed-capital company headquartered in São Paulo, at Rua Costa Carvalho, 300, CEP 05429-900, controlled by the São Paulo State Government. The Company is engaged in the provision of basic and environmental sanitation services in the State of São Paulo, as well as it supplies treated water and sewage services on a wholesale basis.

In addition to providing basic sanitation services in the State of São Paulo, SABESP may perform these activities in other states and countries, and can operate in drainage, urban cleaning, solid waste handling and energy markets. SABESP aims to be a world reference in the provision of sanitation services, in a sustainable, competitive and innovative manner, with a focus on customers.

As of September 30, 2017, the Company operated water and sewage services in 367 municipalities of the State of São Paulo. Most of these municipalities operations are based on 30-year concession, program and services contracts. The Company has two partial contracts with the municipality of Mogi das Cruzes, however, since most of municipality is serviced by wholesale, it was not included in the 367 municipalities. As of September 30, 2017, the Company had 369 contracts.

SABESP is not temporarily operating in the municipalities of Macatuba and Cajobi due to judicial orders. The lawsuits are in progress and the carrying amount of these municipalities' intangible assets was R\$ 4,345 as of September 30, 2017 (R\$ 4,345 as of December 31, 2016).

As of September 30, 2017, 53 concession agreements (54 as of December 31, 2016) had expired and are being negotiated. From October 1, 2017 to 2030, 32 concession agreements will expire. Management believes that concession agreements expired and not yet renewed will result in new contracts, disregarding the risk of discontinuity in the provision of municipal water supply and sewage services. By September 30, 2017, 284 program and services contracts were signed (281 contracts as of December 31, 2016).

As of September 30, 2017, the carrying amount of the underlying assets used in the 53 municipalities under negotiation totaled R\$ 6,616,613, accounting for 20.24% of the total, and the related gross revenue for the nine-month period ended September 30, 2017 totaled R\$ 1,255,378, accounting for 11.26% of the total.

The Company's operations are concentrated in the municipality of São Paulo, which represents 53.64% of the gross revenues on September 30, 2017 (55.35% on September 30, 2016) and 48.46% of intangible assets (46.57% on December 31, 2016).

On June 23, 2010, the State of São Paulo, the Municipality of São Paulo, the Company and the regulatory agency "Sanitation and Energy Regulatory Agency – ARSESP" signed an agreement to share the responsibility for water supply and sewage services to the Municipality of São Paulo based on a 30-year concession agreement. This agreement is extendable for another 30 years, pursuant to the law. This agreement sets forth SABESP as the exclusive service provider and designates ARSESP as regulator, establishing prices, controlling and monitoring services. On the same date, the State of São Paulo, the Municipality of São Paulo and SABESP signed the "Public service provision agreement of water supply and sewage services", a 30-year concession agreement which is extendable for another 30 years. This agreement involves the following activities:

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- i. protection of the sources of water in collaboration with other agencies of the State and the City;
- ii. capture, transport and treatment of water;
- iii. collect, transport, treatment and final dispose of sanitary sewage; and
- iv. adoption of other actions of basic and environmental sanitation.

The Company operates under an authorization by public deed in some municipalities in the Santos coast region and in the Ribeira Valley, where the Company started to operate after the merger of the companies that formed it. In September 2015, the Company entered into a water supply and sewage public utility services agreement with the municipality of Santos; the gross revenue calculated in the nine-month period ended September 30, 2017 totaled R\$ 251,212 (R\$ 206,908 in the period ended September 30, 2016) and the intangible asset was R\$ 299,011 on September 30, 2017 (R\$ 303,540 on December 31, 2016).

Article 58 of Law 11,445/07 determines that precarious and overdue concessions, as well as those effective for an undetermined period of time, including those that do not have an instrument formalizing them, will be valid until December 31, 2010. However, Article 2 of Law 12,693 of July 24, 2012, which amended Article 7-A of Law 11,578, of November 26, 2007, allowed the provision of public basic sanitation services to be executed until December 31, 2016. The Company's Management understands that in the municipalities where the concession agreements were not yet renewed, the operation is governed by Laws 8,987/95 and 11,445/07, including those municipalities served without an agreement.

Public deeds are valid and governed by the Brazilian Civil Code.

The Company's shares have been listed in the Novo Mercado segment of B3 under the ticker symbol SBSP3 since April 2002 and on the New York Stock Exchange (NYSE) as American Depositary Receipts ("ADRs") Level III, under the SBS code, since May 2002.

Since 2008, the Company has been setting up partnerships with other companies, which resulted in the following companies: Sesamm, Águas de Andrada, Saneaqua Mairinque, Aquapolo Ambiental, Águas de Castilho, Attend

Ambiental and Paulista Geradora de Energia. Although SABESP has no majority interest in the capital stock of these companies, the shareholders' agreements provide for the power of veto and casting vote in certain issues jointly with associates, indicating the shared control in the management of investees.

In September 2017, the reservoirs of the São Paulo Metropolitan Region stored approximately 996.7 billion liters of treatment water, versus approximately 831.9 billion liters in September 2016. The month of October marks the beginning of a new hydrological year, 2017/2018 which, under normal conditions, the period from October to March presents the highest rainfall and, consequently, the highest water inflow into the reservoirs. The water year ended in September recorded rainfall indexes close to the historical average, with the Cantareira System receiving 91% of the expected rainfall, while the Alto Tietê System received 80% and the Guarapiranga System 106%. Together, these are the main systems of the São Paulo Metropolitan Region.

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At the end of 2017 and beginning of 2018 two important projects aimed to increase water security in the São Paulo Metropolitan Region are expected to be concluded, as follows: (i) the Jaguarí-Atibainha interconnection, which will allow the transfer of an average annual outflow of 5.13 cubic meters per second (m³/s) and a maximum outflow of 8.5 m³/s from the Paraíba do Sul Basin to the Cantareira System, and which is 90.3% complete; and (ii) the construction of the São Lourenço Production System, which will expand water production and capacity by 6.4 m³/s, and which is 81.1% complete.

Management expects that with the normalization of rainfall, the generation of operating cash and the credit lines available for investment, the Company will have sufficient funds to meet its commitments and not compromise its necessary investments.

Corporate restructuring

As of May 12, 2017, the Board of the State Privatization Program approved:

- (i) the conducting of studies for SABESP's Capitalization (as defined below);
- (ii) the hiring, by SABESP, of the International Finance Corporation, which is associated with the World Bank;
- (iii) the execution of an agreement between SABESP and the State Government through the Water Resources and Sanitation Department and the Treasury Department, in order to define the scope of the contract and control the relationship between the parties, including a proportional expense reimbursement.

The proposed Capitalization provides for the creation of a corporation to directly control SABESP through the transfer of the shares held by the State of São Paulo to the capital stock of the new corporation. The State of São Paulo will continue holding a sufficient number of shares to ensure SABESP's control, as provided for in law. The objective of the Capitalization is to overcome a situation that restricts investments designed to preserve the expansion of activities

to ensure the universalization of basic sanitation services offered by the Company.

The Capitalization may provide for the admission of institutional investors to contribute financial resources to the capital stock of the new company, strengthening SABESP's corporate governance and business efficiency in order to promote and accelerate the universalization of sanitation services in the State of São Paulo.

As of September 15, 2017, Law 16,525 was sanctioned, enacted and published; it provides for the corporate reorganization of Companhia de Saneamento Básico de São Paulo - SABESP and sets forth other provisions.

The main provisions of the Law are:

- The Executive branch is authorized to establish a corporation, governed by Federal Law 6,404/76, to hold basic sanitation and other assets, whose exploration relates to its main purpose ("Parent Company");

- The objective of the Parent Company is, among others:

- (i) Control SABESP;

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(ii) Hold the ownership, manage and explore assets of any nature, aiming the universalization and efficiency of basic sanitation services in the State of São Paulo;

(iii) Structure and implement funding operations to strengthen its ability to execute strategies and initiatives in the basic sanitation sector;

(iv) Assist the State of São Paulo and other federal entities in the implementation of public policies in the basic sanitation sector;

(v) Explore other business opportunities related to the basic sanitation sector inside and outside the State of São Paulo, supported by SABESP;

(vi) Use legally appropriate contractual and corporate arrangements to fulfill its corporate purpose, including the creation of wholly-owned subsidiaries, formation of consortia and holding interests in other public or private companies, provided that approved by the Board of Directors.

- The Government will hold ownership of most of the common shares of the Parent Company; other shareholders may also hold minority interests in the Parent Company;

- Private shareholders will be allowed in the Parent Company in order to contribute capital, add value to the business and strengthen the Company's and the Parent Company's corporate governance, provided that they do not restrict the capacity of the São Paulo State Government to guide them in the attainment of the public interest that justified their creation;

- The São Paulo State Government is authorized to pay-in its interest in the Parent Company's capital through the transfer of the shares it holds in SABESP;

- The Parent Company and SABESP may acquire shares from other state-owned or private companies that have potential synergy with SABESP's activities;
- The Parent Company may increase SABESP's capital to pay-in in cash or with assets, inclusive by holding a tender offer in the capital market; and
- The São Paulo State Government is authorized to sell or encumber the Parent Company's shares or its respective subscription rights, provided that the ownership of most of the common shares is maintained;
- The State Government may waive its preemptive right to subscribe to shares in future capital increases of the Parent Company, in order to enable contributions from new shareholders without losing its the control;
- The São Paulo State Government will mandatorily allocate at least 30% of the proceeds from the sale of the Parent Company's shares to investments in basic sanitation projects;
- A management agreement will be entered into by the São Paulo State Government, the Parent Company and SABESP to strengthen the companies' administrative and financial efficiency;

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- (i) The execution of the management agreement will be preceded by the assumption of SABESP's control by the Parent Company and will establish performance targets related to the reduction of water losses and the universalization of basic sanitation services provided by SABESP;
- (ii) The management agreement will also provide for the increase in the companies' managerial autonomy regarding:
- the definition of a personnel policy;
 - procedures for bids and the contracting of suppliers and service providers;
 - cash management, treasury operations, bank payments of salaries and suppliers; and
 - autonomy for the general shareholders' meeting to establish the salaries and other types of compensation to members of management, based on the limits and parameters established in the management agreement;
- (iii) The agreement will be valid for five years, but may be renegotiated and successively renewed.

The interim financial information was approved by the Board of Directors on November 14, 2017.

2 Basis of preparation and presentation of the financial statements

Presentation of the interim financial information

The interim financial information as of September 30, 2017, was prepared based on the provisions of CPC 21 (R1) – Interim Financial Information and the international standard IAS 34 – Interim Financial Reporting, issued by the International Accounting Standards Board (IASB), applicable to the preparation of Quarterly Information Form– ITR and they are fairly presented consistent with the rules issued by the Brazilian Securities and Exchange Commission (CVM). Therefore, this interim financial information takes into consideration the official letter CVM/SNC/SEP 003 of April 28, 2011, which allows the entities to present selected notes to the financial statements, in cases of redundant information already disclosed in the Annual Financial Statements. The interim financial information for September 30, 2017, therefore, does not include all the notes and reporting required by the annual financial statements, and accordingly, shall be read jointly with the Annual Financial Statements as of December 31, 2016, prepared pursuant to the International Financial Reporting Standards – IFRS, issued by the International Accounting Standards Board – IASB and pursuant to the accounting practices adopted in Brazil which observe the pronouncements issued by the Brazilian Accounting Pronouncements Committee - CPC. Therefore, the interim financial information as of September 30, 2017 was not fully completed due to redundancies with the information presented in the annual financial statements of December 31, 2016 and, as provided for in Official Letter/CVM/SNC/SEP no. 003/2011. In this interim financial information, the notes below was either not presented or are not as detailed as those in the annual financial statements:

- i. Summary of significant accounting policies (Note 3);
- ii. Changes in accounting practices and disclosures (Note 4);
- iii. Risk Management – Financial Instruments (Note 5.4);
- iv. Key Accounting Estimates and Judgments (Note 6);

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- v. Related-Party Balances and Transactions (Note 10);
- vi. Investments (Note 12);
- vii. Intangible Assets (Note 14);
- viii. Borrowings and Financing (Note 16);
- ix. Deferred Taxes and Contributions (Note 18);
- x. Provisions (Note 19);
- xi. Employees Benefits (Note 20);
- xii. Equity (Note 22);
- xiii. Insurance (Note 25);
- xiv. Financial Income (Expenses) (Note 28).

All material information related to the financial statements, and this information alone, is being disclosed and corresponds to the information used by the Company's Management in its administration.

3 Summary of significant accounting policies

The accounting policies used in the preparation of the interim financial information for the quarter ended September 30, 2017 are consistent with those used to prepare the Annual Financial Statements for the year ended December 31, 2016. These policies are disclosed in Note 3 to the Annual Financial Statements.

4 Risk management

4.1 Financial Risk Management

Financial risk factors

The Company's activities are affected by Brazilian economic scenario, making it exposed to market risk (exchange rate and interest rate), credit risk and liquidity risk. The Company's financial risk management is focused on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance.

The Company has not utilized derivative instruments in any of the reported periods.

(a) Market risk

Foreign currency risk

SABESP's foreign exchange exposure implies market risks associated with currency fluctuations, since the Company has foreign currency-denominated liabilities, mainly US dollar and yen-denominated short and long-term borrowings.

The management of SABESP's foreign currency exposure considers several current and projected economic factors, besides market conditions.

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This risk arises from the possibility that the Company may incur in losses due to exchange rate fluctuations that would impact liability balances of foreign currency-denominated borrowings and financing raised in the market and related financial expenses. The Company does not maintain hedge or swap contracts or any derivative financial instrument to hedge against this risk.

A significant amount of the Company's financial debt is indexed to the U.S. dollar and Yen, in the total amount of R\$ 5,435,102 as of September 30, 2017 (R\$ 5,692,984 as of December 31, 2016). Below, the Company's exposure to exchange risk:

| | September 30, 2017 | | December 31, 2016 | |
|---|-----------------------------|------------|-----------------------------|------------|
| | Foreign currency | R\$ | Foreign currency | R\$ |
| Borrowings and financing – US\$ | 1,193,902 | 3,782,282 | 1,241,963 | 4,047,682 |
| Borrowings and financing – Yen | 57,304,600 | 1,611,978 | 57,643,930 | 1,609,419 |
| Interest and charges from borrowings and financing – US\$ | | 37,480 | | 25,114 |
| Interest and charges from borrowings and financing – Yen | | 3,362 | | 10,769 |
| Total exposure | | 5,435,102 | | 5,692,984 |
| Borrowing cost – US\$ | | (28,104) | | (29,650) |
| Borrowing cost – Yen | | (3,074) | | (2,971) |
| Total foreign currency-denominated borrowings (Note 15) | | 5,403,924 | | 5,660,363 |

The 4.5% decrease in foreign-currency denominated debt on September 30, 2017 compared to December 31, 2016, was mainly due to the following:

- 1) Exchange rate changes, due to the 2.8% depreciation in the US dollar, from R\$ 3.2591 as of December 31, 2016 to R\$ 3.1680 as of September 30, 2017. The US dollar-denominated debt accounts for 70.2% of foreign currency-denominated debts; and
- 2) Partial amortization of the BID 713, BID 2202 and AB Loan agreements.

As of September 30, 2017, if the Brazilian real had depreciated or appreciated by 10%, in addition to the impacts mentioned above, against the US dollar and Yen with all other variables held constant, effects on results before taxes on the nine-month period ended September 30, 2017 would have been R\$ 543,510 (R\$ 569,298 for the year ended December 31, 2016), lower or higher, mainly as a result of exchange losses or gains on the translation of foreign currency-denominated loans.

Scenario I below presents the effect in income statements for the next 12 months, considering the projected rates of the U.S. dollar and the Yen. Considering the other variables as remaining constant, the impacts for the next 12 months are shown in scenarios II and III with possible depreciations of 25% and 50%, respectively, in the Brazilian real.

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| | Scenario I (Probable) (*) | Scenario II (+25%) | Scenario III (+50%) |
|---|------------------------------|--------------------|---------------------|
| Net currency exposure as of September 30, 2017 (Liabilities) in US\$ | 1,193,902 | 1,193,902 | 1,193,902 |
| US\$ rate as of September 30, 2017 | 3.1680 | 3.1680 | 3.1680 |
| Exchange rate estimated according to the scenario | 3.3000 | 4.1250 | 4.9500 |
| Differences between the rates | (0.1320) | (0.9570) | (1.7820) |
| Effect on net financial result R\$ - (loss) | (157,595) | (1,142,564) | (2,127,533) |
| Net currency exposure as of September 30, 2017 (Liabilities) in Yen | 57,304,600 | 57,304,600 | 57,304,600 |
| Yen rate as of September 30, 2017 | 0.02813 | 0.02813 | 0.02813 |
| Exchange rate estimated according to the scenario | 0.02890 | 0.03613 | 0.04336 |
| Differences between the rates | (0.00077) | (0.00800) | (0.01523) |
| Effect on net financial result R\$ - (loss) | (44,125) | (458,437) | (872,749) |
| Total effect on net financial result in R\$ - (loss) | (201,720) | (1,601,001) | (3,000,282) |

(*) For the probable scenario in US dollar, the exchange rate estimated for September 30, 2018 was used, pursuant to the Focus Report-BACEN of September 30, 2017, while for the Yen, the average exchange rate was considered for the 12-month period after September 30, 2017, according to B3's Reference Rates report of September 30, 2017.

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Interest rate risk

This risk arises from the possibility that the Company could incur losses due to fluctuations in interest rates, increasing the financial expenses related to borrowings and financing.

The Company has not entered into any derivative contract to hedge against this risk; however continually monitors market interest rates, in order to evaluate the possible need to replace its debt.

The table below provides the Company's borrowings and financing subject to variable interest rate:

| | September 30, 2017 | December 31, 2016 |
|----------------------|-------------------------------|------------------------------|
| TR(i) | 1,569,328 | 1,535,030 |
| CDI(ii) | 1,144,391 | 1,082,228 |
| TJLP(iii) | 1,391,026 | 1,326,631 |
| IPCA(iv) | 1,714,665 | 1,697,452 |
| LIBOR(v) | 2,673,483 | 2,906,999 |
| Interest and charges | 129,017 | 142,644 |
| Total | 8,621,910 | 8,690,984 |

(i) TR – Interest Benchmark Rate

(ii) CDI – (Certificado de Depósito Interbancário), an interbank deposit certificate

(iii) TJLP – (Taxa de Juros a Longo Prazo), a long-term interest rate index

(iv) IPCA – (Índice Nacional de Preços ao Consumidor Amplo), a consumer price index

(v) LIBOR – London Interbank Offered Rate

Another risk to which the Company is exposed, is the mismatch of the monetary restatement indices of its debts with those of its service revenues. Tariff adjustments of services provided by the Company do not necessarily follow the

increases in the inflation indexes to adjust borrowings, financing and interest rates affecting indebtedness.

As of September 30, 2017, if interest rates on borrowings and financing had been 1% higher or lower with all other variables held constant, the effects on profit before taxes for the nine-month period ended September 30, 2017 would have been R\$ 86,219 (R\$ 86,910 as of December 31, 2016), lower or higher, mainly as a result of lower or higher interest expense on floating rate borrowings and financing.

(b) Credit risk

Credit risk arises from cash equivalents, deposits in banks and financial institutions, as well as credit exposures to wholesale basis and retail customers, including outstanding accounts receivable, restricted cash and accounts receivable from related parties. Credit risk exposure to customers is mitigated by sales to a dispersed base.

The maximum exposures to credit risk as of September 30, 2017 are the carrying amounts of instruments classified as cash equivalents, deposits in banks and financial institutions, restricted cash, trade receivables and accounts receivable from related parties at the end of reporting period. See additional information in Notes 6, 7, 8 and 9.

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Regarding the financial assets held with financial institutions, the credit quality that is not past due or subject to impairment can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates. The credit quality of counterparties which are banks, such as deposits and financial investments, the Company considers the lower rating of the counterparty published by three main international rating agencies (Fitch, Moody's and S&P), according to internal policy of market risk management:

| | September 30, 2017 | December 31, 2016 |
|---|---------------------------|--------------------------|
| Cash at bank and short-term bank deposits | | |
| AA+(bra) | 2,055,532 | 1,850,220 |
| AAA(bra) | 35,908 | 35,452 |
| Other (*) | 9,560 | 549 |
| | 2,101,000 | 1,886,221 |

(*) This category includes current accounts and investment funds in banks (the balances of which were not material).

The available credit rating information of the banks, as at September 30, 2017, in which the Company made deposit transactions and financial investments in domestic currency (R\$ - domestic rating) during the period is as follows:

| Banks | Fitch | Moody's | Standard Poor's |
|--------------------------------|--------------|----------------|------------------------|
| Banco do Brasil S/A | AA+(bra) | Aa1.br | - |
| Banco Santander Brasil S/A | - | Aaa.br | brAA- |
| Brazilian Federal Savings Bank | AA+(bra) | Aa1.br | brAA- |
| Banco Bradesco S/A | AAA(bra) | Aa1.br | brAA- |
| Itaú Unibanco Holding S/A | AAA(bra) | Aa1.br | brAA- |

(c) **Liquidity risk**

(b) **Credit risk**

The Company's liquidity is primarily reliant upon cash provided by operating activities, loans from Brazilian Federal and State governmental financial institutions, and financing in the domestic and international capital markets. The liquidity risk management considers the assessment of its liquidity requirements to ensure it has sufficient cash to meet its operating and capital expenditures needs, as well as the payment of debts.

The funds held by the Company are invested in interest-bearing current accounts, time deposits and securities, selecting instruments with appropriate maturity or liquidity sufficient to provide margin as determined by projections mentioned above.

The table below shows the financial liabilities of the Company, into relevant maturities, including the installment of principal and future interest to be paid according to the agreement.

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| | October to December | | | | | | 2022 | |
|--------------------------------------|------------------------------------|-------------|-------------|-------------|-------------|----------------|--------------|--|
| As at September 30, 2017 | 2017 | 2018 | 2019 | 2020 | 2021 | onwards | Total | |
| Liabilities | | | | | | | | |
| Borrowings and financing | 304,994 | 2,186,206 | 2,285,252 | 2,601,131 | 1,116,159 | 6,362,472 | 14,856,214 | |
| Trade payables and contractors | 284,833 | - | - | - | - | - | 284,833 | |
| Services payable | 386,209 | - | - | - | - | - | 386,209 | |
| Public-Private Partnership – PPP (*) | 13,562 | 363,237 | 363,237 | 363,237 | 363,237 | 5,452,092 | 6,918,602 | |
| Program contract commitments | 69,747 | 79,123 | 64,860 | 884 | 1,023 | 16,906 | 232,543 | |

(*) The Company also considered future commitments (construction not yet performed) still not recognized in the financial statements related to São Lourenço PPP, due to the relevance of future cash flows, the impacts on its operations and the fact the Company already has formalized this commitment through an agreement signed by the parties.

Future interest

Future interest was calculated based on the contractual clauses for all agreements. For agreements with floating interest rate, the interest rates used correspond to the base dates above.

Cross default

The Company has borrowings and financing agreements including cross default clauses, i.e., the early maturity of any debt, may imply the early maturity of these agreements. The indicators are continuously monitored in order to avoid the execution of these clauses.

(d) Sensitivity analysis on interest rate risk

The table below shows the sensitivity analysis of the financial instruments, prepared in accordance with CVM Rule 475/2008 in order to evidence the balances of main financial assets and liabilities, calculated at a rate projected for the twelve-month period after September 30, 2017, or until the final settlement of each contract, whichever is shorter, considering a probable scenario (scenario I), appreciation of 25% (scenario II) and 50% (scenario III).

The purpose of the sensitivity analysis is to measure the impact of changes in the market over the financial instruments of the Company, considering constant all other variables. In the time of settlement the amounts can be different from those presented, due to the estimates used in the measurement.

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| Indicators | September 30, 2017 | | | |
|-----------------------------------|--------------------|------------------------------|--------------------|---------------------|
| | Exposure | Scenario I (Probable) (i) | Scenario II 25% | Scenario III 50% |
| Assets | | | | |
| CDI | 2,017,665 | 7.0000%(*) | 5.2500% | 3.5000% |
| Financial income | | 141,237 | 105,927 | 70,618 |
| Liabilities | | | | |
| CDI | (1,144,391) | 7.0000%(*) | 5.2500% | 3.5000% |
| Interest to be incurred | | (80,107) | (60,081) | (40,054) |
| CDI net exposure | 873,274 | 61,130 | 45,846 | 30,564 |
| Liabilities | | | | |
| TR | (1,569,328) | 0.0001%(***) | 0.0001% | 0.0002% |
| Expenses to be incurred | | (2) | (2) | (3) |
| IPCA | (1,714,665) | 4.0600%(*) | 5.0750% | 6.0900% |
| Expenses to be incurred | | (69,615) | (87,019) | (104,423) |
| TJLP | (1,391,026) | 7.0000% (*) | 8.7500% | 10.5000% |
| Interest to be incurred | | (97,372) | (121,715) | (146,058) |
| LIBOR | (2,673,483) | 1.5572% (**) | 1.9466% | 2.3359% |
| Interest to be incurred | | (41,631) | (52,042) | (62,450) |
| Total net expenses to be incurred | | (147,490) | (214,932) | (282,370) |

(*) Source: CDI and IPCA rates (Focus Report – BACEN, September 30, 2017) and long-term interest rate at September 30, 2017 (BACEN).

(**) Source: Bloomberg

(***)Source: B3

(i) Refers to the scenario of interest to be incurred for the 12 months as of September 30, 2017 or until the maturity of the agreements, whichever is shorter.

4.2 Capital management

The Company's objectives when managing capital are ensure its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders, and to maintain an optimal capital structure to reduce the cost of capital.

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The Company monitors capital based on the leverage ratio. This ratio corresponds to net debt divided by total capital. Net debt corresponds to total borrowings and financing less cash and cash equivalents. Total capital is calculated as total equity as shown in the balance sheet plus net debt.

| | September 30, 2017 | December 31, 2016 |
|--|---------------------------|--------------------------|
| Total borrowings and financing (Note 15) | 11,887,771 | 11,964,143 |
| (-) Cash and cash equivalents (Note 6) | (2,101,000) | (1,886,221) |
| | | |
| Net debt | 9,786,771 | 10,077,922 |
| Total equity | 17,263,187 | 15,419,211 |
| | | |
| Total capital | 27,049,958 | 25,497,133 |
| | | |
| Leverage ratio | 36% | 40% |

As of September 30, 2017, the leverage ratio decreased to 36% from the 40% as of December 31, 2016, mainly due to the increase in shareholders' equity, generated by the result recorded from January to September 2017.

4.3 Fair value estimates

It is assumed that balances from trade receivables (current) and accounts payable to suppliers by carrying amount, less impairment approximate their fair values, considering the short maturity. Long-term trade receivables also approximate their fair values, as they will be adjusted by inflation and/or will bear contractual interest rates over time.

4.4 Financial instruments

As of September 30, 2017 and December 31, 2016, the Company did not have financial assets classified as fair value through profit or loss, held to maturity and available for sale neither financial liabilities classified as fair value through profit or loss. The Company's financial instruments included in the borrowings and receivables category comprise cash and cash equivalents, restricted cash, trade receivables, balances with related parties, other receivables, and balances receivable from the Water National Agency – ANA. The financial instruments under the “other liabilities” category comprise accounts payable to contractors and suppliers, borrowings and financing, services payable, balances payable deriving from the Public Private Partnership-PPP and program contract commitments, which are non-derivative financial assets and liabilities with fixed or determinable payments, not quoted in an active market.

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The estimated fair values of financial instruments are as follows:

Financial assets

| | September 30, 2017 | | December 31, 2016 | |
|-----------------------------|---------------------------|-------------------|--------------------------|-------------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| Cash and cash equivalents | 2,101,000 | 2,101,000 | 1,886,221 | 1,886,221 |
| Restricted cash | 15,229 | 15,229 | 24,078 | 24,078 |
| Trade receivables | 1,738,933 | 1,738,933 | 1,711,306 | 1,711,306 |
| Water National Agency – ANA | 73,363 | 73,363 | 81,221 | 81,221 |
| Other receivables | 231,978 | 231,978 | 167,369 | 167,369 |

Additionally, SABESP has financial instrument assets receivables from related parties, in the amount of R\$ 826,530 as of September 30, 2017 (R\$ 871,709 as of December 31, 2016), which were calculated in accordance with the conditions negotiated between related parties. The conditions and additional information referring to these financial instruments are disclosed in Note 9 to this interim financial information and Note 10 to the Annual Financial Statements of December 31, 2016. Part of this balance, totaling R\$ 728,143 (R\$ 788,180 as of December 31, 2016), refers to reimbursement of additional retirement and pension plan - G0 and is indexed by IPCA plus simple interest of 0.5% p.m. This interest rate approximates that one practiced by federal government bonds (NTN-b) with terms similar to those of related-party transactions.

Financial liabilities

| | September 30, 2017 | | December 31, 2016 | |
|----------------------------------|---------------------------|-------------------|--------------------------|-------------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| Borrowings and financing | 11,887,771 | 11,882,054 | 11,964,143 | 11,776,178 |
| Trade payables and contractors | 284,833 | 284,833 | 311,960 | 311,960 |
| Services payable | 386,209 | 386,209 | 460,054 | 460,054 |
| Program contract commitments | 211,297 | 211,297 | 178,093 | 178,093 |
| Public-Private Partnership - PPP | 2,783,204 | 2,783,204 | 2,249,418 | 2,249,418 |

The criteria adopted to obtain the fair values of borrowings and financing, in preparing the interim financial information as of September 30, 2017, are consistent with those adopted in the Annual Financial Statements for the fiscal year ended December 31, 2016. In the Annual Financial Statements, these criteria are disclosed in Note 5.4.

Considering the nature of other financial instruments, assets and liabilities of the Company, the balances recognized in the balance sheet approximate the fair values, taking into account the maturities close to the end of the reporting period, comparison of contractual interest rates with market rates in similar operations at the end of the reporting period, their nature and maturity terms.

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5 Key accounting estimates and judgments

Estimates and judgments are continually evaluated and are based on historical experience and on other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The key accounting estimates and judgments are: (i) allowance for doubtful accounts, (ii) intangible assets resulting from concession and program contracts, (iii) provisions, (iv) pension benefits, and (v) deferred income tax and social contribution, and are disclosed in Note 6 to the Annual Financial Statements as of December 31, 2016.

6 Cash and cash equivalents

| | September 30, 2017 | December 31, 2016 |
|------------------|-------------------------------|------------------------------|
| Cash and banks | 83,335 | 137,395 |
| Cash equivalents | 2,017,665 | 1,748,826 |
| | 2,101,000 | 1,886,221 |

Cash and cash equivalents include cash, bank deposits and high-liquidity short-term financial investments, mainly represented by repurchase agreements (remunerated based on the variation of the Interbank Deposit Certificates (CDI) interest rates), entered into with Banco do Brasil, whose original maturities are lower than three months, which are convertible into a cash amount and subject to an insignificant risk of change in value.

As of September 30, 2017, the average yield of financial investments corresponds to 99.45% of CDI (99.24% as of December 31, 2016).

7 Restricted cash

| | September 30, 2017 | December 31, 2016 |
|---|-------------------------------|------------------------------|
| Agreement with the São Paulo municipal government (i) | 7,931 | 15,858 |
| Brazilian Federal Savings Bank – escrow deposits (ii) | 1,777 | 2,989 |
| Other | 5,521 | 5,231 |
| | 15,229 | 24,078 |

(i) Refers to the amount deducted from the 7.5% of Municipal revenue transferred to the Municipal Fund, corresponding to eventual amounts unpaid by direct management bodies, foundations and government agencies, as established in the agreement entered into with the municipal government of São Paulo; and

(ii) Refers to savings account for receiving escrow deposits regarding lawsuits with final and unappealable decisions in favor of the Company, which are blocked as per contractual clause.

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8 Trade receivables**(a) Statement of financial position details**

| | September 30, 2017 | December 31, 2016 |
|---|-------------------------------|------------------------------|
| Private sector: | | |
| General and special customers (i) (ii) | 1,162,777 | 1,205,498 |
| Agreements (iii) | 330,856 | 315,351 |
| | 1,493,633 | 1,520,849 |
| Government entities: | | |
| Municipal | 537,441 | 520,950 |
| Federal | 4,028 | 3,414 |
| Agreements (iii) | 288,535 | 279,449 |
| | 830,004 | 803,813 |
| Wholesale customers – Municipal governments: (iv) | | |
| Guarulhos | 783,555 | 778,106 |
| Mauá | 514,875 | 467,775 |
| Mogi das Cruzes | 2,684 | 2,527 |
| Santo André | 1,022,367 | 946,045 |
| São Caetano do Sul | 5,147 | 2,371 |
| Diadema | 222,671 | 222,671 |
| | 2,551,299 | 2,419,495 |
| Total wholesale customers – Municipal governments | 2,551,299 | 2,419,495 |

| | | |
|---------------------------------|-------------|-------------|
| Unbilled supply | 511,776 | 481,389 |
| Subtotal | 5,386,712 | 5,225,546 |
| Allowance for doubtful accounts | (3,647,779) | (3,514,240) |
| Total | 1,738,933 | 1,711,306 |
| Current | 1,581,066 | 1,557,472 |
| Noncurrent | 157,867 | 153,834 |
| | 1,738,933 | 1,711,306 |

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- (i) General customers - residential and small and mid-sized companies

- (ii) Special customers – large consumers, commercial industries, condominiums and special billing consumers (fixed demand agreements, industrial waste, wells, etc.);

- (iii) Agreements - installment payments of past-due receivables, plus monetary restatement and interest, when provided for in the agreements; and

- (iv) Wholesale basis customers - municipal governments - This balance refers to the sale of treated water to municipalities, which are responsible for distributing to, billing and charging final customers. Some of these municipalities are questioning in court the tariffs charged by SABESP, which have full allowance for doubtful accounts. Additionally, the overdue amounts are included in the allowance for doubtful accounts.

As of August 28, 2017, the Company and the Guarulhos Water and Sewage Autonomous Service ("SAAE"), resolved to continue preparing: (i) a legal agreement for the installment payment of SAAE's debits with SABESP; and (ii) interdependence agreement to regulate wholesale water supply by SABESP.

The main items of the Proposal for the Debt Negotiation Agreement are:

I. Interdependence agreement to regulate wholesale water supply by SABESP:

- a) Creation of a guarantee of payment to SABESP for the fiduciary sale of SAAE receivables, with automatic separation of the amounts due to SABESP by the bank centralizing payments to SAAE; and

- b) As a result of the provision of the guarantee and the automatic payment, there will be a 20% discount on the monthly billed amount of wholesale water supply services.

II. Legal agreement for the installment payment of SAAE's debits with SABESP:

- a) Debt payment in 480 monthly installments, at an interest rate of 0.5% p.m., adjusted by the IPCA inflation index; and

- b) A 30% discount on the municipality's debt of R\$ 2.9 billion with SABESP, subject to timely payment during the installment period.

It is worth noting that the implementation of the items above depends on prior approval by SABESP's Board of Directors, as well as other approvals to be established by each party and obtained prior to the signature of any binding document.

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(b) The aging of trade receivables is as follows

| | September 30, 2017 | December 31, 2016 |
|----------------------|---------------------------|--------------------------|
| Current | 1,382,862 | 1,337,503 |
| Past-due: | | |
| Up to 30 days | 288,285 | 263,157 |
| From 31 to 60 days | 88,467 | 148,927 |
| From 61 to 90 days | 69,083 | 53,268 |
| From 91 to 120 days | 54,087 | 109,138 |
| From 121 to 180 days | 126,474 | 124,001 |
| From 181 to 360 days | 198,138 | 203,837 |
| Over 360 days | 3,179,316 | 2,985,715 |
| | | |
| Total past-due | 4,003,850 | 3,888,043 |
| | | |
| Total | 5,386,712 | 5,225,546 |

The increase in the overdue balance was mainly due to the default of the municipalities that purchased water on a wholesale basis, given that they are challenging the tariffs charged by SABESP in court.

(c) Allowance for doubtful accounts**January to September 2017 January to September 2016**

| | | |
|---|-----------|-----------|
| Balance at beginning of the period | 3,514,240 | 3,307,793 |
| Private sector /government entities | 57,170 | 121,930 |
| Recoveries | (99,197) | (141,698) |
| Wholesale customers | 182,149 | 231,891 |
| Net additions for the period | 140,122 | 212,123 |
| Write-offs in the period referring to accounts receivable | (6,583) | (19,603) |
| Balance at the end of the period | 3,647,779 | 3,500,313 |

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| | July to | January to | July to | January to |
|---|------------------|-------------------|------------------|-------------------|
| Reconciliation of estimated losses | September | September | September | September |
| of income | 2017 | 2017 | 2016 | 2016 |
| Write-offs | (31,065) | (133,035) | (45,956) | (128,088) |
| Losses/(reversal) with state entities (related parties) | 23,082 | 23,211 | (842) | (4,403) |
| Losses/(reversal) with private sector/government entities | (8,889) | (57,170) | (91,199) | (121,930) |
| Losses/(reversal) with wholesale customers | (18,456) | (19,683) | - | 2,542 |
| Recoveries | 69,708 | 99,197 | 48,289 | 141,698 |
| Amount recorded as selling expenses | 34,380 | (87,480) | (89,708) | (110,181) |

Wholesale sales losses, amounting to R\$ 66,776 from July to September 2017 and R\$ 162,466 from January to September 2017 (R\$ 83,463 from July to September 2016 and R\$ 234,433 from January to September 2016), were also recorded as revenue reduction.

Table of Contents*Gross Profit*

| | For the three months ended April 30, (\$ in thousands) | | | For the six months ended April 30, (\$ in thousands) | | |
|-------------------------|---|-----------|--------------------------------------|---|-----------|------------------------|
| | 2008 | 2007 | Percentage (Decrease) Increase | 2008 | 2007 | Percentage Increase |
| Quality Fragrance Group | \$ 10,916 | \$ 14,640 | (25.4%) | \$ 32,022 | \$ 29,764 | 7.6% |
| Scents of Worth | 5,884 | 5,811 | 1.3% | 17,642 | 17,341 | 1.7% |
| Five Star | 335 | 294 | 13.9% | 913 | 831 | 9.9% |
| Total gross profit | \$ 17,135 | \$ 20,745 | (17.4%) | \$ 50,577 | \$ 47,936 | 5.5% |

The change in total gross profit dollars for the second quarter of fiscal 2008 as compared to the second quarter of fiscal 2007 was primarily attributable to the decrease in Quality Fragrance Group sales. Also contributing to the change were lower margins resulting from increases in manufacturer pricing and from sales of discontinued brands at lower prices than while the respective distribution arrangements were in effect.

Gross Profit Percentages

| | For the three months ended April 30, | | For the six months ended April 30, | |
|-------------------------|--------------------------------------|-------|------------------------------------|-------|
| | 2008 | 2007 | 2008 | 2007 |
| Quality Fragrance Group | 23.9% | 29.8% | 25.0% | 24.8% |
| Scents of Worth | 38.5% | 39.5% | 38.6% | 38.4% |
| Five Star | 33.4% | 29.3% | 34.7% | 41.1% |
| Gross profit percentage | 27.6% | 32.0% | 28.6% | 28.6% |

Gross profit percentages for Model Reorg remained consistent for the six months ended April 30, 2008, as compared to the same period in the prior year, but they decreased during the three months ended April 30, 2008 compared to the same period in the prior year due to Quality Fragrance Group selling a larger portion of lower margin products and Scents of Worth offering greater discounts in 2008 to sell through holiday merchandise remaining in the stores. Five Star's increase in margin relates to product launches during the second quarter of fiscal 2008, which typically are sold at higher margins than existing brands.

Operating Expenses

| | For the three months ended April 30, (\$ in thousands) | | | For the six months ended April 30, (\$ in thousands) | | |
|---|---|-----------|--------------------------------------|---|-----------|--------------------------------------|
| | 2008 | 2007 | Percentage Increase (Decrease) | 2008 | 2007 | Percentage Increase (Decrease) |
| Selling, warehouse, delivery and administrative | \$ 13,417 | \$ 12,334 | 8.8% | \$ 32,950 | \$ 29,509 | 11.7% |
| Depreciation and amortization | 373 | 407 | (8.4%) | 713 | 822 | (13.3%) |
| Total operating expense | \$ 13,790 | \$ 12,741 | 8.2% | \$ 33,663 | \$ 30,331 | 11.0% |
| Income from operations | \$ 3,345 | \$ 8,004 | (58.2%) | \$ 16,914 | \$ 17,605 | (3.9%) |

The increase in selling, warehouse, delivery and administrative expenses for the three months ended April 30, 2008 as compared to the three months ended April 30, 2007 relates to costs to relocate multiple warehouses into the new Bellport facility, as well as increased accounting, auditing and litigation costs. In addition to these costs, the increase for the six months ended April 30, 2008 as compared to the same period in the prior year includes an increase in shipping and warehousing costs related to the increase in sales for Quality Fragrance Group.

Included in operating expenses are allocated operating expenses under the Quality King services arrangements for the three months ended April 30, 2008, which were \$1.8 million or 13.3% of total operating expenses as compared to \$3.0 million or 23.8% of total operating expenses for the three months ended April 30, 2007. Allocated operating expenses for the six months ended April 30, 2008 were \$4.9 million or 14.5% of total operating expenses, as compared to \$6.0 million or 19.7% of total operating expenses for the six months ended April 30, 2007.

Table of Contents*Interest Expense*

| | For the three months ended April 30, (\$ in thousands) | | | For the six months ended April 30, (\$ in thousands) | | |
|--|---|----------|------------------------|---|----------|------------------------|
| | 2008 | 2007 | Percentage Decrease | 2008 | 2007 | Percentage Decrease |
| | Interest expense | \$ 2,135 | \$ 2,770 | 22.9% | \$ 5,300 | \$ 6,104 |

The decrease in interest expense relates to a decrease in the interest rates on the revolving credit facility and intercompany payable to Quality King of approximately 2.5% during the second quarter 2008 and 1.9% during the six months ended April 30, 2008, as compared to the same periods in the prior year.

Income Taxes

| | For the three months ended April 30, (\$ in thousands) | | | For the six months ended April 30, (\$ in thousands) | | |
|--|---|--------|------------------------|---|----------|------------------------|
| | 2008 | 2007 | Percentage Decrease | 2008 | 2007 | Percentage Increase |
| | Income taxes | \$ 505 | \$ 2,094 | 75.9% | \$ 4,860 | \$ 4,600 |

The decrease in income taxes for the three months ended April 30, 2008 as compared to the three months ended April 30, 2007 is principally the result of the decrease in income before taxes of \$4.0 million. In addition, income taxes for both the three and six months ended April 30, 2008 reflect additional taxes paid for state income tax audits.

Liquidity and Capital Resources

Model Reorg's principal capital requirements for operating purposes are to fund inventory purchases, finance extended terms on accounts receivable, specifically related party receivables from E Com, and pay down accounts payable and debt. During fiscal 2007, Model Reorg financed these requirements through net cash flows from financing activities, specifically the revolving credit borrowings, while during the first half of fiscal 2008, it relied primarily on reductions in inventory and collections of unaffiliated receivables.

A summary of Model Reorg's cash flows for the years ended October 31, 2007 and 2006, and the six months ended April 30, 2008 and 2007 are as follows:

| | Six Months Ended April 30, | | Year Ended October 31, | |
|---|----------------------------|-----------|------------------------|-----------|
| | 2008 | 2007 | 2007 | 2006 |
| | (\$ in thousands) | | | |
| Summary Cash Flow Information: | | | | |
| Cash provided by (used in) operating activities | \$ 41,502 | \$ 37,886 | \$ (12,307) | \$ 39,234 |
| Cash used in investing activities | (3,771) | (1,241) | (2,115) | (4,610) |
| Cash (used in) provided by financing activities | (35,583) | (37,175) | 14,673 | (34,408) |
| Increase (decrease) in cash | 2,148 | (530) | 251 | 216 |
| Cash at beginning of period | 2,988 | 2,737 | 2,737 | 2,521 |
| Cash at end of period | \$ 5,136 | \$ 2,207 | \$ 2,988 | \$ 2,737 |

Management expects to continue to finance fiscal 2008 requirements primarily through operating activities.

Model Reorg, along with Quality King is part of a \$500 million revolving line of credit with a syndicate of lenders that expires on April 30, 2010. As of April 30, 2008, \$102.2 million was outstanding for Model Reorg under this line of credit. The credit agreement provides for borrowing based on eligible accounts receivable and inventories and is secured by Model Reorg's accounts receivable and inventories. The

interest rate applicable to borrowings under the credit agreement is based on the monthly blended borrowing rates, which are based on, at Quality King's option, the LIBOR rate or the prime rate plus an applicable spread based on availability. At April 30, 2008, substantially all of the revolving credit borrowings were at LIBOR plus the applicable spread, the effective rate of which approximated 4.4%. The borrowings under the credit agreement are classified as long term based on the expiration date of the facility.

Model Reorg has a note payable to Quality King which is classified as long-term since Quality King will not require payment of the loan within one year. This note supplements Model Reorg's borrowings under the line of credit described above. Model Reorg is charged interest by Quality King based on the monthly blended borrowing rates, which are based on the LIBOR and prime rates, plus a spread based on excess availability. Interest rates on the note for the six months ended April 30, 2008 averaged 5.4%. Interest expense charged to operations relating to the note payable was \$4,571 for fiscal year 2007 and \$1,961 for the six months ended April 30, 2008.

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For the six months ended April 30, 2008, net cash provided by operating activities was approximately \$41.5 million, resulting from a decrease in accounts receivable and inventory after the holiday season. Net cash used in investing activities for the six months ended April 30, 2008 was approximately \$3.8 million. These were primarily purchases of property, plant and equipment for the relocation to the Bellport warehouse and capitalized Merger-related expenses. Net cash used in financing activities of \$35.6 million principally relates to the decrease in the revolving credit borrowings and pay down of affiliated note payable from the funds provided by operating activities.

Management believes that Model Reorg's borrowing capacity under its current facility, projected cash flows from operations, affiliated borrowings and credit terms from vendors will provide sufficient liquidity to support its capital expenditures and debt service for the foreseeable future. There can be no assurance that management's plans and expectations will be successful.

Critical Accounting Policies and Estimates

There have been no material changes to our critical accounting policies and estimates from our fiscal year ended October 2007.

Contractual Obligations

Following is a summary of Model Reorg's contractual obligations as of October 31, 2007. See also Approval to Issue Shares and Warrants Post-Merger Financing for a discussion of the Senior Credit Facility we expect that the combined company will enter into upon the closing of the Merger.

| Contractual Obligations (1) | Total | Payments due by period (\$ in thousands) | | | |
|------------------------------|-------------------|---|-------------------|-----------------|----------------------|
| | | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Revolving line of credit (2) | \$ 138,278 | \$ | \$ 138,278 | \$ | \$ |
| Operating lease obligations | 64,066 | 2,735 | 8,760 | 7,959 | 44,612 |
| Minimum royalty obligations | 5,604 | 2,085 | 3,119 | 400 | |
| Other | 845 | 209 | 543 | 93 | |
| Total | \$ 208,793 | \$ 5,029 | \$ 150,700 | \$ 8,452 | \$ 44,612 |

(1) Affiliated borrowings from Quality King in the amount of \$76.3 million at October 31, 2007 are not included in this schedule as there are no specified repayment terms on these borrowings.

(2) This balance represents principal only as the interest rate is variable and accrues on outstanding balances, which vary significantly throughout the year.

Off-Balance Sheet Arrangements

Model Reorg has no off-balance sheet arrangements as defined in Item 303(a)(4) of SEC Regulation S-K.

Recent Accounting Standards

In June 2006, the FASB issued FIN 48, which clarifies the accounting for the uncertainty in income taxes recognized under SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on various related matters such as derecognition, interest and penalties and disclosures. The effective date of FIN 48 for non-public enterprises is for annual periods beginning after December 15, 2007. Model Reorg has begun evaluating the financial impact of applying the provisions of FIN 48 to all tax provisions and it does not believe there will be a material financial impact upon the initial adoption of FIN 48.

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UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS

The following unaudited pro forma condensed combined financial statements give effect to the proposed Merger. Pursuant to the Merger Agreement, we will acquire all of the outstanding share capital of Model Reorg in exchange for the Merger Consideration. Two Model Reorg shareholders currently own 44.5% of our common stock on a fully-diluted basis. Following the Merger, the former shareholders of Model Reorg will hold an aggregate of approximately 79.3% of our outstanding common stock on a fully diluted basis. Due to a number of factors, including that the shares issued to Model Reorg's shareholders in the Merger will constitute a majority of the outstanding shares of our common stock after the transaction, Model Reorg is deemed to be the acquiring company for accounting purposes. Accordingly, the purchase price is allocated among the fair values of our assets and liabilities, while the assets and liabilities of Model Reorg are reflected at historical cost in the combined condensed pro forma balance sheet. The transaction will be accounted for under the purchase method of accounting in accordance with SFAS 141. Under the purchase method of accounting, since Model Reorg is deemed to be the acquiror for accounting purposes, the total estimated purchase price, calculated as described below in Note 1 to the unaudited pro forma condensed combined balance sheet, is allocated to the net tangible and intangible assets acquired and liabilities assumed of E Com in connection with the transaction, based on their estimated fair values as of the completion of the Merger.

The unaudited pro forma condensed combined financial statements presented below are based upon the historical financial statements of both companies, reflecting the restatement of our financial statements for reporting periods ending before 2008 as described in Note 3 to our Consolidated Financial Statements beginning on page F-13, adjusted to give effect to our acquisition by Model Reorg. The pro forma adjustments are described in the accompanying notes presented on the following pages. Because Model Reorg is considered to be the acquiring company, the statement of operations information is presented below as of October 31, 2007 and April 30, 2008, the last day of Model Reorg's most recently completed fiscal year and interim period, respectively, and the balance sheet information is presented as of April 30, 2008. However, going forward, the combined company will continue to use our fiscal year end, the Saturday closest to January 31, which is conventional for retail businesses, as well as the corresponding Saturdays as the end of each fiscal quarter.

The amounts in the unaudited pro forma condensed combined financial statements are subject to a final determination of the fair market value of our assets acquired and liabilities assumed. The final purchase price allocation may be materially different from the allocation used in calculating goodwill for the pro forma adjustments shown below. As a result, actual income from operations may differ significantly from the pro forma amounts included below. There can be no assurance that such adjustments will not be material to the combined financial statements.

All intercompany balances and transactions between Model Reorg and E Com, consisting primarily of sales, purchases, profits in ending inventory, receivables and payables, as of the dates and for the periods of these unaudited pro forma combined financial statements, have been eliminated in the unaudited pro forma combined financial statements. Certain reclassification adjustments have been made to conform our historical reported balances to Model Reorg's financial statement basis of presentation.

The unaudited pro forma condensed combined financial statements are provided for illustrative purposes only and do not purport to represent the financial condition or results of operations had the Merger been completed as of the dates indicated, nor are they necessarily indicative of future consolidated results of operations or financial position.

The unaudited pro forma condensed combined financial statements do not include the realization of cost savings from operating efficiencies, synergies, or other restructurings effects resulting from the Merger.

The unaudited pro forma condensed combined financial statements should be read in conjunction with our historical financial statements and accompanying notes and the historical financial statements and accompanying notes of Model Reorg, which are included elsewhere in this Proxy Statement.

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| | As of April 30, 2008 | | | | Pro Forma Combined Model Reorg and E Com |
|--|----------------------|-------------|---|-------------|---|
| | Historical E Com | Model Reorg | Pro Forma Adjustments (\$ in thousands) | | |
| Assets | | | | | |
| Current: | | | | | |
| Cash | \$ 1,280 | \$ 5,136 | | \$ | \$ 6,416 |
| Accounts receivable net | 1,216 | 28,407 | | | 29,623 |
| Receivables from an affiliate | 235 | 35,844 | (a) | (36,079) | |
| Inventories, net | 118,857 | 193,620 | (h) | (4,923) | 306,172 |
| | | | (i) | (1,382) | |
| Advances to suppliers for future purchases | | 2,085 | | | 2,085 |
| Prepays and other | 8,527 | 5,724 | (l) | (1,798) | 12,453 |
| Total current assets | 130,115 | 270,816 | | (44,182) | 356,749 |
| Property and equipment, net | 38,476 | 3,141 | | | 41,617 |
| Goodwill | 1,904 | 20,434 | (g) | 2,172 | 22,606 |
| | | | (m) | (1,904) | |
| Other assets, net | 7,273 | 12,147 | (f) | (5,484) | 13,936 |
| | \$ 177,768 | \$ 306,538 | | \$ (49,398) | \$ 434,908 |
| Liabilities and Shareholders Equity | | | | | |
| Current: | | | | | |
| Accounts payable, non affiliates | 22,899 | 22,965 | | | 45,864 |
| Accounts payable, affiliates | 55,891 | 144 | (a) | (36,079) | 19,956 |
| Accrued expenses | 10,974 | 12,211 | (j) | (2,522) | 16,054 |
| | | | (l) | (4,609) | |
| Bank line of credit | 42,590 | | (b) | (42,590) | |
| Current maturities of long-term debt | 5,364 | 208 | | | 5,572 |
| Total current liabilities | 137,718 | 35,528 | | (85,800) | 87,446 |
| Long-term debt and other | 7,090 | 102,733 | (b) | 32,502 | 142,325 |
| Payable to affiliates | | 76,912 | (b) | 10,088 | 87,000 |
| Total liabilities | 144,808 | 215,173 | | (43,210) | 316,771 |
| Commitments and Contingencies | | | | | |
| Shareholders equity | | | | | |
| Common stock | 40 | 1 | (e) | 59 | 99 |
| | | | (d) | (1) | |
| Additional paid in capital | 79,183 | 13,905 | (e) | (59) | 50,128 |
| | | | (k) | (37,686) | |
| | | | (d) | 1 | |
| | | | (f) | (5,484) | |
| | | | (g) | 2,172 | |
| | | | (m) | (1,904) | |
| Retained earnings (deficit) | (37,686) | 78,934 | (k) | 37,686 | 76,487 |
| | | | (c) | (1,475) | |
| | | | (h)(i)(j) | (3,783) | |

| | | | | | |
|----------------------------------|---------------|---------------|-----|----------------|----------------|
| | | | (l) | 2,811 | |
| Treasury Stock | (8,577) | (1,475) | (c) | 1,475 | (8,577) |
| Total shareholders equity | 32,960 | 91,365 | | (6,188) | 118,137 |
| | \$ 177,768 | \$ 306,538 | | \$ (49,398) | \$ 434,908 |

- (a) Adjustment to eliminate intercompany payable and receivables between E Com and Model Reorg
- (b) Adjustment to reflect the post-merger financing, which is expected to include a new a \$250 million revolving credit facility and the pay down of related party debt. (See Approval to Issue Shares and Warrants Post-Merger Financing and Affiliate Debt.)
- (c) Adjustment to record retirement of Model Reorg treasury stock
- (d) Adjustment to record the cancellation of Model Reorg common stock
- (e) Adjustment to record the issuance of additional 5,900,000 shares of E Com common stock
- (f) Adjustment to record estimated transaction fees, which are reflected as a component of purchase price. See Note 1 below.
- (g) Adjustment to record goodwill related to the Merger. Goodwill is calculated as the excess of purchase price over the fair value of the assets acquired and liabilities assumed. See Note 1 below.
- (h) Adjustment to remove any affiliated profit in E Com inventory as of April 2008
- (i) Adjustment to remove any affiliated profit in Model Reorg inventory as of April 2008
- (j) Tax effect of the pro forma adjustments at 40%, which approximates Model Reorg s effective tax rate
- (k) Adjustment to eliminate E Com s historical accumulated deficit
- (l) Adjustment to reverse E Com s accrued straight line rent and deferred rent, which does not represent a legal obligation of the combined company, and will have no value, upon completion of the Merger, and its related Deferred Tax Asset
- (m) Adjustment to eliminate E Com s pre-merger goodwill of \$1.9 million
- Note 1: Since Model Reorg is deemed to be the acquirer for accounting purposes, in accordance with GAAP, the total purchase price will be determined based on the fair value of the outstanding shares of E Com prior to the Merger, plus the Model Reorg transaction costs. Preliminary estimated transaction costs and purchase price are as follows (the actual purchase price will be calculated based on the fair value of the E Com shares at the date the Merger is consummated and the actual transaction costs):

| | <i>(\$ in thousands)</i> |
|-------------------------------------|--------------------------|
| Fair value of E Com common stock(x) | \$ 62,037 |
| Estimated transaction costs | 5,484 |
| | \$ 67,521 |

(x) 3,059,041 E Com common shares outstanding as of April 30, 2008 at a closing market price of \$20.28 per share.

Under the purchase method of accounting, for purposes of the table above, the total preliminary estimated purchase price is allocated to the E Com net tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the completion date of the Merger. The preliminary estimated purchase price has been allocated based on estimates taking into account various factors as described in the introduction to these unaudited pro forma condensed combined financial statements. The allocation of the preliminary estimated purchase price is as follows:

| | <i>(\$ in thousands)</i> |
|-----------------------------|--------------------------|
| Current assets | \$ 123,159 |
| Property and equipment, net | 38,476 |
| Other assets | 7,273 |
| Goodwill | 2,172 |
| Liabilities assumed | (103,559) |
| | \$ 67,521 |

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| | Twelve Months Ended October 31, 2007 | | | Pro Forma Combined Model Reorg and E Com |
|--|--------------------------------------|--|--------------------------|---|
| | E Com* | Historical Model Reorg (\$ in thousands, except weighted average and per share amounts) | Pro Forma Adjustments | |
| Net sales, unaffiliated | \$ 236,089 | \$ 302,530 | \$ | \$ 538,619 |
| Net sales, affiliated | 48,910 | 25,182 | (a) (74,092) | |
| Total net sales | 284,999 | 327,712 | (74,092) | 538,619 |
| Cost of goods sold | 174,426 | 237,203 | (a) (74,092) | 339,337 |
| | | | (b)(c) 1,800 | |
| Gross profit | 110,573 | 90,509 | (1,800) | 199,282 |
| Selling, warehouse, delivery and administrative expenses | 95,812 | 60,113 | (d) 1,200 | 156,566 |
| | | | (g) (559) | |
| Depreciation and amortization | 5,847 | 1,411 | | 7,258 |
| Recovery on vendor advances | | (2,367) | | (2,367) |
| Income from operations | 8,914 | 31,352 | (2,441) | 37,825 |
| Interest expense | 4,912 | 12,749 | | 17,661 |
| Income before income taxes | 4,002 | 18,603 | (2,441) | 20,164 |
| Income taxes | 79 | 7,353 | (e)(f) 633 | 8,065 |
| Net income | \$ 3,923 | \$ 11,250 | \$ (3,074) | \$ 12,099 |
| Weighted average shares | | | | |
| Basic(h) | 3,055,510 | 5,900,000 | | 8,955,510 |
| Diluted(h) | 3,569,706 | 5,900,000 | | 9,469,706 |
| Net income (loss) per share | | | | |
| Basic(h) | \$ 1.28 | \$ 1.91 | \$ (0.34) | \$ 1.35 |
| Diluted(h) | \$ 1.23 | \$ 1.91 | \$ (0.32) | \$ 1.33 |

* E Com's historical statement of operations for the twelve months ended October 31, 2007 combines the results of the fourth quarter of E Com's 2006 fiscal year with those of the first nine months of its 2007 fiscal year.

(a) Adjustment to eliminate affiliated sales and purchases

(b) Adjustment to remove the increase in affiliated profit in E Com inventory in the amount of \$800 as of October 31, 2007

(c) Adjustment to remove the increase in affiliated profit in Model Reorg inventory in the amount of \$1,000 as of October 31, 2007

- (d) Adjustment to write off E Com capitalized transaction costs
- (e) Tax effect of the pro forma adjustments at 40%, which approximates Model Reorg's effective tax rate (See Note 1 below)
- (f) To adjust tax expense to the combined companies' effective tax rate of approximately 40% (See Note 1 below)
- (g) Adjustment to reverse E Com's accrued straight line rent, which does not represent a legal obligation of the combined company, and will have no value, upon completion of the Merger
- (h) Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. In computing diluted net income per share, the weighted average number of common shares outstanding includes all common stock equivalents with exercise prices at or below the average market price for the respective period. The calculations for the twelve months ended October 31, 2007 are as follows:

| | E Com | Model Reorg | Pro Forma Adjustments | Pro Forma Combined Model Reorg and E Com |
|---|---|----------------|--------------------------|---|
| | <i>(\$ in thousands, except weighted average and per share amounts)</i> | | | |
| Numerator: | | | | |
| Net income (loss) - Basic | \$ 3,923 | \$ 11,250 | \$(3,074) | \$ 12,099 |
| Add: Interest on Convertible Note | 473 | | | 473 |
| Net income (loss) - Diluted | \$ 4,396 | \$ 11,250 | \$ (3,074) | \$ 12,572 |
| Denominator: | | | | |
| Weighted average number of shares for basic net income (loss) per share | 3,055,510 | 5,900,000 | 8,955,510 | 8,955,510 |
| Shares issuable upon exercise of stock options | 69,751 | | 69,751 | 69,751 |
| Convertible Note | 444,445 | | 444,445 | 444,445 |
| Denominator for dilutive net income (loss) per share | 3,569,706 | 5,900,000 | 9,469,706 | 9,469,706 |
| Basic net income (loss) per common share | \$ 1.28 | \$ 1.91 | \$ (0.34) | \$ 1.35 |
| Diluted net income (loss) per common share | \$ 1.23 | \$ 1.91 | \$ (0.32) | \$ 1.33 |

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Pro forma share numbers represent the weighted average shares outstanding of E Com for the twelve months ended October 31, 2007, assuming the issuance at the beginning of the period of the 5.9 million shares issuable in the Merger. Pro forma share numbers used in the computation of diluted net income per share also assume the issuance of 69,751 shares issuable upon exercise of stock options for the twelve months ended October 31, 2007 and 444,445 shares of our common stock upon conversion of the Convertible Note. The 1.5 million Warrant shares are not included in the pro forma share numbers since they would be antidilutive.

Note 1: The adjustment of \$0.633 million to increase income tax expense consists of a provision for \$1.833 million and a benefit of \$1.2 million. The provision for \$1.863 million results from the requirement to reflect the effective E Com income tax expense in this pro forma statement of operations for a period other than that of E Com's normal fiscal year and \$0.559 million to reverse E Com's accrued straight line rent, which will have no value upon completion of the Merger. The benefit results from the reduction of the pro forma income tax expense as a result of the elimination of an aggregate of \$1.8 million of affiliated profit in inventory and the write off of \$1.2 million of E Com's capitalized transaction cost. This capitalized transaction cost is reflected here as a charge to the pro forma condensed combined statement of operations because Model Reorg is deemed to be the acquiring company and only Model Reorg's transaction costs are appropriate for capitalization.

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| | Six Months ended April 30, 2008 | | | |
|---|---|----------------|--------------------------|-----------------------------------|
| | Historical | | | Pro Forma |
| | E Com* | Model Reorg | Pro Forma Adjustments | Combined Model Reorg and E Com |
| | (\$ in thousands, except weighted average | | | |
| | and per share amounts) | | | |
| Net sales, unaffiliated | \$ 145,663 | \$ 156,902 | | \$ 302,565 |
| Net sales, affiliated | 21,287 | 19,685 | (a) | (40,972) |
| Total net sales | 166,950 | 176,587 | | (40,972) 302,565 |
| Cost of goods sold | 102,225 | 126,010 | (a) | (40,972) 187,712 |
| | | | (b)(c) | 449 |
| Gross profit | 64,725 | 50,577 | | (449) 114,853 |
| Selling, warehouse, delivery and administrative expenses | 56,990 | 32,950 | (f) | (138) 89,802 |
| Depreciation and amortization | 3,440 | 713 | | 4,153 |
| Recovery on vendor advances | | | | |
| Income from operations | 4,295 | 16,914 | | (311) 20,898 |
| Interest expense | 1,898 | 5,300 | | 7,198 |
| Income before income taxes | 2,397 | 11,614 | | (311) 13,700 |
| Income tax expense | 1,502 | 4,860 | (d)(e) | (882) 5,480 |
| Net income | \$ 895 | \$ 6,754 | | \$ 571 \$ 8,220 |
| Weighted Average shares | | | | |
| Basic(g) | 3,059,041 | 5,900,000 | | 8,959,041 |
| Diluted(g) | 3,059,041 | 5,900,000 | | 9,478,899 |
| Net Income (loss) per share | | | | |
| Basic(g) | \$ 0.29 | \$ 1.14 | | \$ 0.06 \$ 0.92 |
| Diluted(g) | \$ 0.29 | \$ 1.14 | | \$ 0.06 \$ 0.89 |

* E Com's historical statement of operations for the six months ended April 30, 2008 combines the results of the last quarter of E Com's 2007 fiscal year with those of the first quarter of its 2008 fiscal year.

(a) Adjustment to eliminate affiliated sales and purchases

(b) Adjustment to remove the increase in affiliated profit in E Com Ventures inventory in the amount of \$0.805 million as of April 30, 2008

(c) Adjustment to add the decrease in affiliated profit in Model Reorg inventory in the amount of \$0.356 million as of April 30, 2008

(d) Tax effect of the pro forma adjustments at 40%, which approximates Model Reorg's effective tax rate

(e) To adjust tax expense to the combined company's effective tax rate of approximately 40% (See Note 1 below)

- (f) Adjustment to reverse E Com's accrued straight line rent and deferred rent, which does not represent a legal obligation of the combined company, and will have no value, upon completion of the Merger
- (g) Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. In computing diluted net income per share, the weighted average number of common shares outstanding includes all common stock equivalents with exercise prices at or below the average market price for the respective period. The calculations for the six months ended April 30, 2008 are as follows:

| | E Com | Model Reorg | Pro Forma Adjustments | Pro Forma Combined Model Reorg and E Com |
|--|---|----------------|--------------------------|---|
| | <i>(\$ in thousands, except weighted average and per share amounts)</i> | | | |
| Numerator: | | | | |
| Net income - Basic | \$ 895 | \$ 6,754 | \$ 571 | \$ 8,220 |
| Add: Interest on Convertible Note | | | | 187 |
| Net income - Diluted | \$ 895 | \$ 6,754 | \$ 571 | \$ 8,407 |
| Denominator: | | | | |
| Shares issuable upon exercise of stock options | | | 8,959,041 | 8,959,041 |
| Convertible Note | | | 75,413 | 75,413 |
| Weighted average number of shares for basic net income per share | 3,059,041 | 5,900,000 | 444,445 | 444,445 |
| Denominator for dilutive net income per share | 3,059,041 | 5,900,000 | 9,478,899 | 9,478,899 |
| Basic net income per common share | \$ 0.29 | \$ 1.14 | \$ 0.06 | \$ 0.92 |
| Diluted net income per common share | \$ 0.29 | \$ 1.14 | \$ 0.06 | \$ 0.89 |

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Pro forma share numbers represent the weighted average shares outstanding of E Com for the six months ended April 30, 2008, assuming the issuance at the beginning of the period of the 5.9 million shares issuable in the Merger. Pro forma share numbers used in the computation of diluted net income per share also assume the issuance of 75,413 shares issuable upon exercise of stock options for the six months ended April 30, 2008 and 444,445 shares of our common stock upon conversion of the Convertible Note. The 1.5 million Warrant shares are not included in the pro forma share numbers since they would be antidilutive.

Note 1: The adjustments of \$0.882 million to decrease income tax expense consists of a provision for \$0.055 million and a benefit of \$0.937 million. The provision for \$0.055 million results from the reversal of E Com's accrued straight line rent of \$0.138 million, which will have no value upon completion of the Merger. The benefit results from the reduction of the pro forma tax expense as a result of the elimination of an aggregate of \$0.449 million of affiliated profit in inventory and an adjustment to realign tax expense to Model's estimated effective rate of 40%.

Table of Contents**SELECTED FINANCIAL PROJECTIONS**

Neither we nor Model Reorg, as a matter of course, make public forecasts or projections as to future financial performance. However, during 2007, we and Model Reorg's management prepared prospective financial information to present certain projections of financial performance for the respective companies, and these projections were provided to the Special Committee, Financo and our Board in connection with their financial analyses of the proposed Merger. In June 2008, we and Model Reorg's management updated our projections for EBITDA for the twelve months ended October 31, 2008, which we provided to the Special Committee and our Board for use in their consideration of the First Amendment, together with projections of interest costs through October 31, 2010.

None of these projections were prepared with a view toward public disclosure, nor with a view toward complying with the guidelines of the American Institute of Certified Public Accountants with respect to prospective financial information, but, in the view of our management and Model Reorg management, they were prepared on a reasonable basis, reflect the best estimates and judgments available as of the date of their preparation, and present, to the best of each management's knowledge and belief as of the date of their preparation, the expected course of action and the expected future financial performance of the respective company. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and readers of this Proxy Statement are cautioned not to place undue reliance on this information. The projections are forward-looking statements inherently subject to the general risks that we and Model Reorg face in our businesses, including those discussed under "Risk Factors" in this Proxy Statement and the factors described under "Forward-Looking Statements" in this Proxy Statement.

Neither our nor Model Reorg's independent auditors, nor any other independent accountants, have compiled, examined, or performed any procedures with respect to the prospective financial information contained herein, nor have they expressed any opinion or any other form of assurance on such information or its achievability, and they assume no responsibility for, and disclaim any association with, this prospective financial information.

Set forth below are material projections of EBITDA for the respective companies on a standalone basis and for the combined company that we and Model Reorg prepared. All these projections other than the ones labelled "Updated" were provided to the Special Committee, Financo and our Board in 2007. Those labelled "Updated" were provided to the Special Committee and our Board in June 2008. These financial forecasts and the assumptions underlying them have not been updated since their respective dates of preparation.

| | Twelve Months Ended October 31, (\$ in thousands) | | | |
|------------------|---|----------------|-----------|-----------|
| | 2008 | | 2009 | 2010 |
| | <i>Original</i> | <i>Updated</i> | | |
| EBITDA | | | | |
| E Com | \$ 14,743 | \$ 9,902 | \$ 16,424 | \$ 19,466 |
| Model Reorg | 42,694 | 36,118 | 47,066 | 49,081 |
| Combined Company | 57,437 | 46,020 | 63,490 | 68,547 |

EBITDA consists of net income excluding income tax provision, interest expense, depreciation and amortization. Projected EBITDA for E Com and Model Reorg for the respective twelve-month periods ending October 31 is reconciled to net income as follows:

| | 2008 | | 2009 | 2010 |
|---------------------------------------|-----------------|----------------|-----------|-----------|
| | <i>Original</i> | <i>Updated</i> | | |
| E Com | | | | |
| EBITDA | \$ 14,743 | \$ 9,902 | \$ 16,424 | \$ 19,466 |
| Interest expense | 4,119 | 3,764 | 4,771 | 5,399 |
| Income taxes | 2,021 | 138 | 2,009 | 2,411 |
| Depreciation and amortization expense | 5,312 | 5,784 | 6,363 | 7,721 |
| Net Income | \$ 3,291 | \$ 216 | \$ 3,281 | \$ 3,935 |

Model Reorg

| | | | | |
|---------------------------------------|-----------|-----------|-----------|-----------|
| EBITDA | \$ 42,694 | \$ 36,118 | \$ 47,066 | \$ 49,081 |
| Interest expense | 11,744 | 11,318 | 15,527 | 15,151 |
| Income taxes | 12,106 | 9,364 | 12,190 | 13,134 |
| Depreciation and amortization expense | 1,319 | 1,389 | 1,364 | 1,396 |

Net Income \$ 17,525 \$ 14,047 \$ 17,985 \$ 19,400

Combined Company

| | | | | |
|---------------------------------------|-----------|-----------|-----------|-----------|
| EBITDA | \$ 57,437 | \$ 46,020 | \$ 63,490 | \$ 68,547 |
| Interest expense | 15,863 | 15,082 | 20,298 | 20,550 |
| Income taxes | 14,127 | 9,502 | 14,199 | 15,545 |
| Depreciation and amortization expense | 6,631 | 7,173 | 7,727 | 9,117 |

Net Income \$ 20,816 \$ 14,263 \$ 21,266 \$ 23,335

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While presented with numeric specificity, the foregoing financial projections reflect numerous important assumptions, many of which are highly subjective, made by our and Model Reorg management in light of business, industry and market conditions at the time of their respective preparation. These assumptions include the following:

With respect to E Com:

Opening of 50 (for the Updated 2008 EBITDA projections above, an increase from the 45 used for the Original projection), 45 and 50 new stores in 2008, 2009, 2010, respectively, and closing of an average of five stores per year.

A calculated rate of average retail sales growth over the three years that is higher than our experience in recent years due to the greater number of new stores opened during the period, partially offset by the projected lower average sales volume derived from new stores generally.

An additional amount of retail sales growth due to: increased marketing efforts leading to greater recognition of the Perfumania brand name, continuing improvement in merchandise assortment, a recent national trend of consumers favoring retail stores over department stores, a reduction in the number of department stores due to industry consolidation, and continuing remodeling of Perfumania stores to standardize and improve store design and appearance.

A small increase in wholesale sales in 2008.

Capital expenditures of \$15.1 million (for the Updated 2008 EBITDA projections above, an increase from the \$12.9 million used for the Original projection), \$14.9 million and \$17.7 million in 2008, 2009 and 2010, respectively, relating primarily to opening of new stores, renovation of existing stores and replacement/upgrade of store point of sale register hardware and software.

Moderate increase in store operating expenses as a percentage of retail sales due to the projected increase in new store openings. (New stores tend to incur higher operating expenses as a percentage of sales in the first few years after opening compared with more mature stores due to new store lower initial sales contributions.)

A gradual decrease in corporate office expenses as a percentage of retail sales.

A moderate increase in interest expense due to assumed increased utilization of credit facility to support new store openings.

With respect to Model Reorg:

The Original 2008 EBITDA projection above was based on the assumption of an increase in revenues of approximately 10% for fiscal 2008 relating to the establishment of two significant manufacturer relationships not previously available to Model Reorg. The assumed increase was reduced to 3.5% for purposes of the Updated 2008 EBITDA projection.

While an increase of approximately 5% was projected for sales to existing retail customers during fiscal 2008 for purposes of the Original 2008 projection, the Updated 2008 EBITDA projection assumes no such increase.

No net increase in the number of customers in fiscal 2009 and 2010, but a 4.5% annual increase in sales in those years due to more extensive merchandise offerings.

Capital expenditures of \$0.8 million, \$1.7 million and \$1.3 million in 2008, 2009 and 2010, respectively.

Warehouse consolidation savings from combining seven warehouse locations into the single Bellport facility, such as rent, supplies, payroll and related benefits, were budgeted at \$0.1 million per month beginning February 2008.

Salaries were budgeted with a 4% cost of living increase each fiscal year.

We and Model Reorg also provided the Special Committee and our Board with interest expense projections regarding the proposed new Senior Credit Facility and Affiliate Debt arrangements showing that the combined company's aggregate interest expense, based on anticipated debt levels, is expected to be less than was projected under the arrangements contemplated by the Original Merger Agreement.

There can be no assurance that the assumptions made in preparing the financial projections will prove accurate. In addition, the financial projections do not take into account any of the costs of the transactions contemplated by the Merger Agreement, including the costs of the Merger, the related financing transactions, and any integration costs or savings from the Merger. Management cannot predict the actual integration costs or the savings, if any, that will be achieved when E Com and Model Reorg are combined.

EBITDA has limitations, including that it:

is not necessarily comparable to other similarly titled financial measures of other companies due to the potential inconsistencies in the method of calculation;

does not reflect actual cash expenditures, future requirements for capital expenditures or contractual commitments;

does not reflect the significant interest expense or cash requirements necessary to service interest or principal payments on our, Model Reorg's or the combined company's debt;

does not reflect any cash income taxes that we, Model Reorg or the combined company may be required to pay; and

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although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future and these measures do not reflect any cash requirements for such replacements.

Therefore, EBITDA should not be considered either in isolation or as a substitute for analysis of our results as reported under GAAP.

Furthermore, EBITDA should not be considered as an alternative to operating income (loss) or net income (loss) as a measure of operating performance or to net cash provided by operating, investing or financing activities, or as a measure of the ability of any of us, Model Reorg or the combined company to meet cash needs.

The assumptions and estimates underlying the prospective financial information set forth above are inherently uncertain and, though considered reasonable by our and Model Reorg management, respectively, as of the date of its preparation, are subject to a wide variety of significant business, economic, and competitive risks and uncertainties that could cause actual results to differ materially from those contained in the prospective financial information, including, among others, the risks and uncertainties described in Risk Factors and Forward-Looking Statements. Accordingly, there can be no assurance that the prospective results are indicative of our future performance or that of the combined company or that actual results will not differ materially from those presented in the prospective financial information. Inclusion of the prospective financial information in this Proxy Statement should not be regarded as a representation by any person that the results contained in the prospective financial information will be achieved.

Neither we nor Model Reorg intends to update or otherwise revise the prospective financial information to reflect circumstances existing or events occurring, including changes in general economic or industry conditions, since its preparation, even if any or all of the underlying assumptions are shown to be in error.

Table of Contents**MARKET PRICE AND DIVIDEND INFORMATION; RELATED SHAREHOLDER MATTERS**

Our common stock is traded on the NASDAQ Capital Market under the symbol ECMV. The following table sets forth the high and low closing sales prices per share of our common stock for the periods indicated, as reported on the NASDAQ Capital Market.

| | High | Low |
|-----------------------------------|-------------|------------|
| <u>Fiscal 2008</u> | | |
| First Quarter | \$ 26.92 | \$ 14.02 |
| Second Quarter (through July [7]) | \$ 23.25 | \$ [17.00] |
| <u>Fiscal 2007</u> | | |
| First Quarter | \$ 31.53 | \$ 23.07 |
| Second Quarter | 27.87 | 21.95 |
| Third Quarter | 26.41 | 19.01 |
| Fourth Quarter | 27.31 | 18.99 |
| <u>Fiscal 2006</u> | | |
| First Quarter | \$ 21.92 | \$ 16.00 |
| Second Quarter | 23.20 | 10.60 |
| Third Quarter | 16.65 | 8.83 |
| Fourth Quarter | 24.17 | 13.94 |

As of June 24, 2008, we had 46 shareholders of record, which excludes shareholders holding shares in street name. On November 16, 2006 and December 20, 2007, the last full trading days before the days on which we issued press releases announcing the proposed Merger and the execution of the Original Merger Agreement, respectively, the closing prices per share of our common stock as reported on the NASDAQ Capital Market was \$18.08 and \$23.94, respectively.

We have not declared or paid any dividends on our common stock and do not currently intend to declare or pay cash dividends in the foreseeable future. Payment of dividends, if any, will be at the discretion of the Board of Directors after taking into account various factors, including our financial condition, results of operations, current and anticipated cash needs and plans for expansion. In addition, any third party senior credit facility that we obtain from time to time will restrict our payment of dividends.

There is currently no public market for Model Reorg common stock. Upon completion of the Merger, all outstanding shares of Model Reorg common stock will convert automatically into shares of our common stock in accordance with the Merger Agreement. There are seven holders of the outstanding shares of Model Reorg common stock.

Table of Contents**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following tables set forth the beneficial ownership by the persons listed below of shares of our common stock and Model Reorg common stock, respectively, at the Record Date, June 24, 2008, and giving effect to the Merger. At the Record Date, we had 3,059,041 shares outstanding and Model Reorg had 96.9 shares outstanding. Beneficial ownership is determined under the rules of the SEC and includes voting or dispositive power over the securities. Shares of our common stock subject to the Convertible Note and the Warrants, and shares subject to options that are exercisable currently or within 60 days of the Record Date are considered beneficially owned by the person holding the Convertible Note, Warrants, and/or options, respectively, for the purpose of computing the percentage ownership of that person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person. Unless otherwise indicated, each person has sole voting and investment power over the shares shown or shares such power with his or her spouse.

Ownership of E Com Before the Merger

The following table sets forth the beneficial ownership of our common stock at the Record Date by each person that is the beneficial owner of more than five percent of our common stock, each of our current director and officers, and all such directors and executive officers as a group.

| | Shares Owned | Percent of Class |
|---|-----------------|---------------------|
| <u>Principal Shareholders</u> | | |
| Stephen L. Nussdorf and Glenn H. Nussdorf | | |
| 35 Sawgrass Drive | | |
| Bellport, New York 11713 | 1,557,589(1) | 44.5% |
| Jeffrey L. Feinberg | | |
| JLF Asset Management, L.L.C. | | |
| 2775 Via de la Valle Suite 204 | | |
| Del Mar, CA 92014 | 600,703(2) | 19.6% |
| Steven L. Martin | | |
| Slater Capital Management, L.L.C. | | |
| 825 Third Avenue 33rd Floor | | |
| New York, NY 10022 | 213,900(3) | 7.0% |
| <u>Other Directors and Executive Officers</u> | | |
| Michael W. Katz | 100,000(4) | 3.2% |
| Alan Grobman | 0 | |
| Joseph Bouhadana | 5,000(4) | * |
| Paul Garfinkle | 4,500(4) | * |
| Carole A. Taylor | 3,000(4) | * |
| Donovan Chin | 27,250(4) | * |
| All current directors and executive officers as a group | | |
| (7 persons) | 1,697,339(4) | 46.6% |

* Indicates less than 1%.

- (1) Includes 444,445 shares of common stock issuable upon conversion of the Convertible Note as to which Stephen and Glenn Nussdorf would share voting and investment power.
- (2) As reported in a Schedule 13G filed with the SEC on February 13, 2008, Mr. Feinberg and JLF Asset Management, L.L.C. share voting and investment power over these shares. Mr. Feinberg is the Managing Member of JLF Asset Management, L.L.C., which controls JLF Partners I, L.P. and JLF Offshore Fund, Ltd., which share voting and investment power over their respective shares. As reported in a Form 4 filed on March 21, 2008, JLF Offshore Fund, Ltd. holds 334,558 of these shares (10.9% of the class) and the remaining 266,145 shares are held in accounts of private investment vehicles.
- (3) As reported in a Schedule 13G filed with the SEC on February 15, 2008, Mr. Martin is the manager of Slater Capital Management, L.L.C., with which he shares voting and investment power over these shares, which are held in private investment funds for the benefit of clients. Additional information was provided in a Form 13F filed with the SEC by Slater Capital Management, L.L.C. on May 13, 2008.
- (4) Includes shares of common stock issuable upon the exercise of stock options exercisable currently or within 60 days of the Record Date in the following amounts: Michael W. Katz (100,000); Joseph Bouhadana (5,000); Paul Garfinkle (4,500); Carole A. Taylor (3,000); Donovan Chin (27,250); and all current directors and executive officers as a group (139,750).

Table of Contents**Ownership of Model Reorg Before the Merger**

The following table sets forth the beneficial ownership of Model Reorg common stock at the Record Date by each person that is the beneficial owner of more than five percent of Model Reorg's common stock, each current director and executive officer of Model Reorg, and all such directors and executive officers as a group.

| | Shares Owned | Percent of Class |
|---|--------------------------------|---------------------|
| Stephen L. Nussdorf | 28 ² / ₃ | 29.5838 |
| Glenn H. Nussdorf | 28 ² / ₃ | 29.5838 |
| Arlene Nussdorf | 28 ² / ₃ | 29.5838 |
| Rene A. Garcia | 10.9(1) | 11.2486 |
| Michael W. Katz | 0 | |
| All current directors and executive officers as a group | | |
| (4 persons) | 57 ¹ / ₃ | 59.167 |

- (1) Includes a total of 5,232 shares (5.4% of the class) held by trusts for the benefit of Mr. Garcia's children, for which Mr. Garcia and Rafael Villoldo serve as trustees and as to which they disclaim any pecuniary interest.

Pro Forma Ownership of Combined Company

The following table provides information, after giving pro forma effect to the Merger, with respect to the anticipated beneficial ownership of our common stock by each person expected to be the beneficial owner of more than five percent of our common stock anticipated to be outstanding after the Merger, each person expected to be a director or executive officer following the Merger, and all such directors and executive officers as a group (based on each such person's current beneficial ownership of our and/or Model Reorg shares). The amounts shown for the Model Reorg shareholders include the aggregate 295,000 shares that we will hold in escrow following the Merger.

| | Shares Owned Excluding Warrants | Percent of Class | Shares Owned Assuming Exercise of Warrants (1) | Percent of Class |
|---|---------------------------------------|---------------------|---|---------------------|
| Principal Shareholders | | | | |
| Stephen L. Nussdorf and Glenn H. Nussdorf | 5,048,477(2) | 53.7% | 5,935,991(3) | 57.7% |
| Arlene Nussdorf | 1,745,444 | 19.5% | 2,189,201(4) | 23.3% |
| Rene A. Garcia | 663,668(5) | 7.4% | 832,397(6) | 9.1% |
| Jeffrey L. Feinberg | 600,703(7) | 6.7% | 600,703(7) | 6.7% |
| Other Directors and Executive Officers | | | | |
| Michael W. Katz | 100,000(8) | 1.1% | 100,000(8) | * |
| Joseph Bouhadana | 5,000(8) | * | 5,000(8) | * |
| Paul Garfinkle | 4,500(8) | * | 4,500(8) | * |
| Carole A. Taylor | 3,000(8) | * | 3,000(8) | * |
| Donna Dellomo | | * | | * |
| Raymond Piergiorgi | | * | | * |
| Donovan Chin | 27,250(8) | * | | * |
| All directors and executive officers as a group (8 persons) | 5,188,227(8) | 54.4% | 6,075,741(8)(9) | 58.2% |

* Indicates less than 1%.

- (1) Warrants are not exercisable until the third anniversary of the effective date of the Merger, subject to acceleration in certain circumstances (see Approval to Issue Shares and Warrants The Warrants).
- (2) Includes 444,445 shares of common stock issuable upon conversion of the Convertible Note as to which Stephen and Glenn Nussdorf would share voting and investment power.
- (3) Includes 443,757 shares issuable upon exercise of Warrants issuable to each of Stephen and Glenn Nussdorf.
- (4) Includes 443,757 shares issuable upon exercise of Warrants.
- (5) Includes a total of 318,561 shares held by trusts for the benefit of Mr. Garcia s children, for which Mr. Garcia and Rafael Villoldo serve as trustees and as to which they disclaim any pecuniary interest.
- (6) Includes a total of 168,729 shares issuable upon exercise of Warrants issuable to Mr. Garcia and the trusts for the benefit of Mr. Garcia s children.
- (7) As reported in a Schedule 13G filed with the SEC on February 13, 2008, Mr. Feinberg and JLF Asset Management, L.L.C. share voting and investment power over these shares. Mr. Feinberg is the Managing Member of JLF Asset Management, L.L.C.,

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which controls JLF Partners I, L.P. and JLF Offshore Fund, Ltd., which share voting and investment power over their respective shares.

- (8) Includes shares of common stock issuable upon the exercise of stock options exercisable currently or within 60 days of the Record Date in the following amounts: Michael W. Katz (100,000); Joseph Bouhadana (5,000); Paul Garfinkle (4,500); Carole A. Taylor (3,000); Donovan Chin (27,250); and all current directors and executive officers as a group (139,750).
- (9) Includes an aggregate of 887,514 shares issuable upon exercise of Warrants beneficially owned by Stephen Nussdorf.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any document we file at the SEC's Public Reference Room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549, and you may also obtain copies by mail, at prescribed rates, from the Public Reference Section of the SEC at the same address. You may call the SEC at 1-800-732-0330 for information on the Public Reference Room. The SEC maintains a website that contains annual, quarterly and current reports, proxy statements and other information that issuers, including us, file electronically with the SEC. The SEC's website is located at www.sec.gov.

We have supplied all information contained in this Proxy Statement relating to us, and Model Reorg has supplied all such information relating to Model Reorg.

You should rely only on the information contained in this Proxy Statement to vote on the proposals at the Special Meeting. We have not authorized anyone to provide you with information that is different from what is contained in this Proxy Statement. This Proxy Statement is dated July [], 2008. You should not assume that the information contained in the Proxy Statement is accurate as of any date other than such date, and neither the mailing of this Proxy Statement to shareholders nor the issuance of our common stock in the Merger shall create any implication to the contrary.

SHAREHOLDER PROPOSALS FOR THE 2008 ANNUAL MEETING

Shareholder proposals intended to be presented at our 2008 Annual Meeting of Shareholders pursuant to the provisions of Rule 14a-8 of the Securities and Exchange Commission promulgated under the Securities Exchange Act of 1934, as amended, must be received by our Corporate Secretary at the address below by September 12, 2008 for inclusion in our Proxy Statement and form of proxy relating to such Annual Meeting. Any shareholder proposal submitted other than for inclusion in our proxy materials for that meeting must be delivered to us no later than November 26, 2008, or such proposal will be considered untimely. If a shareholder proposal is received after November 26, 2008, we may vote in our discretion as to the proposal all of the shares for which we have received proxies for the 2008 Annual Meeting of Shareholders.

Send all proposals or nominations to Donovan Chin, Secretary, E Com Ventures, Inc., 251 International Parkway, Sunrise, Florida 33325.

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E Com Ventures, Inc. and Subsidiaries

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

E Com Ventures, Inc.

Sunrise, Florida

We have audited the accompanying consolidated balance sheets of E Com Ventures, Inc. and subsidiaries (the Company) as of February 2, 2008 and February 3, 2007, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended February 2, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, such consolidated financial statements present fairly, in all material respects, the financial position of E Com Ventures, Inc. and subsidiaries as of February 2, 2008 and February 3, 2007, and the results of their operations and their cash flows for each of the three years in the period ended February 2, 2008, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3, the accompanying consolidated financial statements for the years ended February 3, 2007 and January 28, 2006 have been restated.

/S/ DELOITTE & TOUCHE LLP
Deloitte & Touche LLP

Certified Public Accountants

Fort Lauderdale, Florida

June 5, 2008

Table of Contents**E COM VENTURES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

| | FEBRUARY 2, 2008 | FEBRUARY 3, 2007 (AS RESTATED, SEE NOTE 3) |
|---|-----------------------|---|
| ASSETS: | | |
| Current assets: | | |
| Cash | \$ 1,035,073 | \$ 1,282,546 |
| Trade receivables, no allowance required | 1,057,499 | 954,664 |
| Deferred tax asset-current | 2,261,856 | 2,821,584 |
| Inventories, net | 107,479,019 | 78,427,029 |
| Prepaid expenses and other current assets | 2,228,013 | 3,469,201 |
| Total current assets | 114,061,460 | 86,955,024 |
| Property and equipment, net | 36,587,935 | 28,246,433 |
| Goodwill | 1,904,448 | 1,904,448 |
| Deferred tax asset: non-current | 6,980,518 | 7,228,179 |
| Other assets, net | 300,250 | 388,099 |
| Total assets | \$ 159,834,611 | \$ 124,722,183 |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | |
| Current liabilities: | | |
| Accounts payable - non affiliates | \$ 19,609,065 | \$ 16,748,142 |
| Accounts payable - affiliates | 48,650,294 | 24,110,130 |
| Accrued expenses and other liabilities | 10,327,794 | 8,304,225 |
| Bank line of credit | 32,840,872 | 26,919,115 |
| Subordinated convertible note payable - affiliate | 5,000,000 | |
| Current portion of obligations under capital leases | 355,376 | 345,424 |
| Total current liabilities | 116,783,401 | 76,427,036 |
| Subordinated convertible note payable - affiliate | | 5,000,000 |
| Long-term portion of obligations under capital leases | 7,190,268 | 7,552,915 |
| Total liabilities | 123,973,669 | 88,979,951 |
| Commitments and contingencies (See Note 12) | | |
| Shareholders' equity: | | |
| Preferred stock, \$0.10 par value, 1,000,000 shares authorized, none issued | | |
| Common stock, \$0.01 par value, 6,250,000 shares authorized; 3,957,290 and 3,950,664 shares issued at fiscal year-end 2007 and 2006, respectively | 39,573 | 39,507 |
| Additional paid-in capital | 79,182,694 | 79,069,780 |
| Accumulated deficit | (34,784,381) | (34,790,111) |
| Treasury stock, at cost, 898,249 shares | (8,576,944) | (8,576,944) |
| Total shareholders' equity | 35,860,942 | 35,742,232 |
| Total liabilities and shareholders' equity | \$ 159,834,611 | \$ 124,722,183 |

See accompanying notes to consolidated financial statements.

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E COM VENTURES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

| | FOR THE FISCAL YEAR ENDED | | |
|--|---------------------------|---|---|
| | February 2, 2008 | February 3, 2007 (as restated, see Note 3) | January 28, 2006 (as restated, see Note 3) |
| Net sales to: | | | |
| Unrelated customers | \$ 244,119,470 | \$ 229,985,494 | \$ 215,849,482 |
| Affiliates | 57,715,160 | 13,623,604 | 17,844,599 |
| | 301,834,630 | 243,609,098 | 233,694,081 |
| Cost of goods sold to: | | | |
| Unrelated customers | 135,507,782 | 126,983,531 | 120,490,161 |
| Affiliates | 54,461,686 | 12,695,946 | 16,702,761 |
| | 189,969,468 | 139,679,477 | 137,192,922 |
| Gross profit | 111,865,162 | 103,929,621 | 96,501,159 |
| Operating expenses: | | | |
| Selling, general and administrative expenses | 99,974,054 | 89,003,867 | 81,005,603 |
| Depreciation and amortization | 6,196,880 | 4,796,947 | 4,830,371 |
| Total operating expenses | 106,170,934 | 93,800,814 | 85,835,974 |
| Income from operations | 5,694,228 | 10,128,807 | 10,665,185 |
| Other expenses: | | | |
| Interest expense | | | |
| Affiliates | (451,354) | (465,798) | (371,458) |
| Other | (4,277,077) | (4,028,943) | (3,506,018) |
| | (4,728,431) | (4,494,741) | (3,877,476) |
| Income before income taxes | 965,797 | 5,634,066 | 6,787,709 |
| Income tax (provision) benefit | (960,067) | (1,244,404) | 8,471,308 |
| Net income | \$ 5,730 | \$ 4,389,662 | \$ 15,259,017 |
| Basic net income per common share | \$ | \$ 1.46 | \$ 5.17 |
| Diluted net income per common share | \$ | \$ 1.38 | \$ 4.51 |
| Weighted average number of shares outstanding: | | | |
| Basic | 3,058,797 | 3,000,471 | 2,949,146 |
| Diluted | 3,058,797 | 3,505,890 | 3,463,480 |

See accompanying notes to consolidated financial statements.

Table of Contents**E COM VENTURES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY****FOR THE FISCAL YEARS ENDED FEBRUARY 2, 2008, FEBRUARY 3, 2007 AND JANUARY 28, 2006**

| | Common Stock | | Additional Paid-In Capital | Treasury Stock | | Accumulated Deficit | Total |
|---|--------------|-----------|----------------------------------|----------------|----------------|------------------------|---------------|
| | Shares | Amount | | Shares | Amount | | |
| Balance at January 29, 2005 as originally reported | 3,834,684 | \$ 38,347 | \$ 75,347,588 | 898,249 | \$ (8,576,944) | \$ (51,748,982) | \$ 15,060,009 |
| Prior period adjustment, see Note 3 | | | | | | (2,689,808) | (2,689,808) |
| Balance at January 29, 2005 (as restated, see Note 3) | 3,834,684 | 38,347 | 75,347,588 | 898,249 | (8,576,944) | (54,438,790) | 12,370,201 |
| Net income (as restated, see Note 3) | | | | | | 15,259,017 | 15,259,017 |
| Exercise of stock options | 22,532 | 225 | 83,507 | | | | 83,732 |
| Receipt of profits under Section 16(b) - short swing profit liability of the Exchange Act | | | 181,591 | | | | 181,591 |
| Excess tax benefit from exercise of stock options | | | 2,242,000 | | | | 2,242,000 |
| Executive compensation contributed to capital | | | 406,000 | | | | 406,000 |
| Balance at January 28, 2006 (as restated, see Note 3) | 3,857,216 | 38,572 | 78,260,686 | 898,249 | (8,576,944) | (39,179,773) | 30,542,541 |
| Net income (as restated, see Note 3) | | | | | | 4,389,662 | 4,389,662 |
| Exercise of stock options | 93,448 | 935 | 681,209 | | | | 682,144 |
| Share based compensation expense | | | 64,256 | | | | 64,256 |
| Excess tax benefit from exercise of stock options | | | 63,629 | | | | 63,629 |
| Balance at February 3, 2007 (as restated, see Note 3) | 3,950,664 | 39,507 | 79,069,780 | 898,249 | (8,576,944) | (34,790,111) | 35,742,232 |
| Net income | | | | | | 5,730 | 5,730 |
| Exercise of stock options | 6,626 | 66 | 36,170 | | | | 36,236 |
| Share based compensation expense | | | 70,719 | | | | 70,719 |
| Excess tax benefit from exercise of stock options | | | 6,025 | | | | 6,025 |
| Balance at February 2, 2008 | 3,957,290 | \$ 39,573 | \$ 79,182,694 | 898,249 | \$ (8,576,944) | \$ (34,784,381) | \$ 35,860,942 |

See accompanying notes to consolidated financial statements.

Table of Contents**E COM VENTURES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | FOR THE FISCAL YEAR ENDED | | |
|--|---------------------------|---|---|
| | February 2, 2008 | February 3, 2007 (as restated, see Note 3) | January 28, 2006 (as restated, see Note 3) |
| Cash flows from operating activities: | | | |
| Net income | \$ 5,730 | \$ 4,389,662 | \$ 15,259,017 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Deferred income taxes | 807,389 | 1,063,404 | (8,871,305) |
| Tax benefit from exercise of stock options | 34,428 | 63,629 | |
| Excess tax benefit from stock option exercises | (6,025) | (63,629) | |
| Provision for impairment of assets and store closings | 333,550 | 165,847 | 162,370 |
| Depreciation and amortization | 6,196,880 | 4,796,947 | 4,830,371 |
| Share-based compensation | 70,719 | 64,256 | |
| Change in operating assets and liabilities: | | | |
| Trade receivables | (102,835) | (135,592) | (123,260) |
| Inventories | (29,051,990) | (5,450,185) | 5,952,794 |
| Prepaid expenses and other current assets | 1,241,188 | (2,519,055) | 199,577 |
| Other assets | 87,171 | 68,850 | 218,281 |
| Accounts payable, non-affiliate | 2,861,818 | 3,142,103 | (4,640,529) |
| Accounts payable, affiliates | 24,540,164 | (2,795,303) | 3,677,108 |
| Accrued expenses and other liabilities | 1,715,872 | (166,143) | 1,859,501 |
| Net cash provided by operating activities | 8,734,059 | 2,624,791 | 18,523,925 |
| Cash flows from investing activities: | | | |
| Additions to property and equipment | (14,592,855) | (9,797,300) | (7,143,201) |
| Net cash used in investing activities | (14,592,855) | (9,797,300) | (7,143,201) |
| Cash flows from financing activities: | | | |
| Net borrowings (repayments) under bank line of credit | 5,921,757 | 6,771,137 | (11,380,234) |
| Principal payments under capital lease obligations | (352,695) | (322,299) | (254,912) |
| Proceeds from exercise of stock options | 36,236 | 682,144 | 83,732 |
| Excess tax benefit from stock option exercises | 6,025 | 63,629 | |
| Receipt of profits under Section 16(b)- short swing profit liability of the Exchange Act | | | 181,591 |
| Net cash provided by (used in) financing activities | 5,611,323 | 7,194,611 | (11,369,823) |
| (Decrease) increase in cash and cash equivalents | (247,473) | 22,102 | 10,901 |
| Cash and cash equivalents at beginning of period | 1,282,546 | 1,260,444 | 1,249,543 |
| Cash and cash equivalents at end of period | \$ 1,035,073 | \$ 1,282,546 | \$ 1,260,444 |
| Cash paid during the period for: | | | |
| Interest | \$ 4,643,408 | \$ 4,379,131 | \$ 3,612,573 |
| Income taxes | \$ 231,444 | \$ 306,963 | \$ 200,000 |

See accompanying notes to consolidated financial statements.

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E COM VENTURES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE FISCAL YEARS ENDED FEBRUARY 2, 2008, FEBRUARY 3, 2007 AND JANUARY 28, 2006

NOTE 1 - NATURE OF BUSINESS

E Com Ventures, Inc., a Florida corporation (ECOMV or the Company), performs all of its operations through two wholly-owned subsidiaries, Perfumania, Inc. (Perfumania), a Florida corporation, which is a specialty retailer and wholesaler of fragrances and related products and perfumania.com, inc., a Florida corporation which is an Internet retailer of fragrances and other specialty items.

Perfumania's retail stores are located in regional malls, manufacturers' outlet malls, life style centers, airports and on a stand-alone basis in suburban strip shopping centers, throughout the United States and Puerto Rico. The number of retail stores in operation at February 2, 2008, February 3, 2007, and January 28, 2006 were 303, 267 and 239, respectively.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

Significant accounting principles and practices used by the Company in the preparation of the accompanying consolidated financial statements are as follows:

FISCAL YEAR END

The Company's fiscal year ends on the Saturday closest to January 31 to enable the Company's operations to be reported in a manner which more closely coincides with general retail reporting practices and the financial reporting needs of the Company. In the accompanying notes, fiscal year 2007, 2006 and 2005 refer to the years ended February 2, 2008, February 3, 2007 and January 28, 2006, respectively. Fiscal years 2007 and 2005 each contain fifty-two weeks, while fiscal year 2006 contains fifty-three weeks, with the fifty-third week falling in the fiscal fourth quarter.

MANAGEMENT ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates made by management in the accompanying consolidated financial statements relate to the valuation of inventory balances, self-insured health care accruals, long-lived asset impairments and estimated useful lives of property and equipment, deferred tax assets and goodwill. Actual results could differ from those estimates.

RECLASSIFICATIONS

Certain amounts from the prior periods have been reclassified to conform to the current period presentation. Net sales and cost of goods sold on our consolidated statements of operations for fiscal years 2006 and 2005 were reclassified to disclose transactions with both unrelated customers and affiliates. These reclassifications had no effect on net income, as previously reported.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include accounts of E Com Ventures, Inc. and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

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TRADE RECEIVABLES

The Company's trade receivables consist primarily of credit card receivables relating to the Company's retail stores. Generally, there are three to four days of retail sales transactions outstanding with third-party credit card vendors at any point in time.

INVENTORIES

Inventories, consisting of finished goods, are stated at the lower of cost or market with cost being determined on a weighted average method. The cost of inventory includes product cost and freight charges. Writeoffs of potentially slow moving or damaged inventory are recorded based on management's analysis of inventory levels, future sales forecasts and through specific identification of obsolete or damaged merchandise. Inventory shrinkage is estimated and accrued between physical inventory counts.

PROPERTY AND EQUIPMENT

Property and equipment is carried at cost, less accumulated depreciation and amortization. Depreciation for property and equipment, which includes assets under capital leases, is calculated using the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the shorter of the term of the lease including one stated renewal period that is reasonably assured, or the estimated useful lives of the improvements, generally ten years. Costs of major additions and improvements are capitalized and expenditures for maintenance and repairs which do not extend the useful life of the asset are expensed when incurred. Gains or losses arising from sales or retirements are reflected in operations.

GOODWILL

Goodwill represents the excess purchase price paid over net assets of businesses acquired resulting from the application of the purchase method of accounting. Goodwill is not amortized but is tested annually for impairment at the end of the Company's fiscal year or more frequently if events or changes in circumstances indicate the carrying value of goodwill may not fully be recoverable. No impairment was identified as a result of the annual tests in fiscal years 2007, 2006, and 2005.

OTHER INTANGIBLE ASSETS

Other intangible assets include store design, real estate leases and non-compete agreements which were recorded based upon their relative fair values at the date of acquisition as determined by management. Other intangible assets do not include goodwill. The amortization of intangible assets totaled approximately \$140,000 in fiscal year 2005. There was no amortization of intangible assets during fiscal years 2007 and 2006 as all intangible assets with finite lives were fully amortized as of the beginning of the fiscal year 2006.

GIFT CARDS

Upon the purchase of a gift card by a retail customer, a liability is established for the cash value of the gift card. The liability is included in accrued expenses and other liabilities. The liability is relieved and revenue is recognized at the time of the redemption of the gift card. Over time, some portion of gift cards issued is not redeemed. This amount is recorded as a reduction of selling, general and administrative expenses, when it can be determined that the likelihood of the gift card being redeemed is remote and there is no legal obligation to remit the unredeemed gift cards to relevant jurisdictions (often referred to as gift card breakage). Gift cards issued by the Company do not have expiration dates. In fiscal year 2007, we recorded gift card breakage of approximately \$140,000. There was no gift card breakage recorded in prior years.

REVENUE RECOGNITION

Revenue from wholesale transactions is recorded upon shipment of inventory when risk of ownership and title transfers to the buyer. Revenue from store sales is recorded, net of discounts, at the point of sale. Revenue from Internet sales is recognized at the time products are delivered to customers. Shipping and handling revenue from our Internet sales is included as a component of net sales and amounted to approximately \$298,000, \$289,000 and \$367,000 in fiscal years 2007, 2006 and 2005, respectively. Revenue from gift cards is recognized at the time of redemption. Returns of store and Internet sales are allowed within 30 days of purchase.

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SALES RETURN ALLOWANCE

Allowances for retail sales returns are estimated and accrued based on our historical return patterns. Historical sales returns have not been significant. In fiscal year 2007, the Company accrued a sales return allowance of approximately \$150,000. No allowance was recorded in prior years.

COST OF GOODS SOLD

Cost of goods sold include the cost of merchandise sold, inventory valuation, inventory shortages, damages and freight charges. Costs relating to our distribution center are included in selling, general and administrative expenses and were approximately \$2.8 million, \$2.6 million and \$2.4 million in fiscal years 2007, 2006 and 2005, respectively.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses include payroll and related benefits for our store operations, field management, distribution center and corporate office; rent, common area maintenance, real estate taxes and utilities for our stores, distribution center and corporate office; advertising, insurance, supplies, professional fees and other administrative expenses. Included in selling, general and administrative expenses in fiscal year 2007 are \$1.2 million of expenses related to a planned merger with Model Reorg, Inc. These expenses consist primarily of financial advisory, legal and due diligence fees. See further discussion at Note 6.

INCOME TAXES

Income tax expense is based principally on pre-tax financial income. Deferred tax assets and liabilities are recognized for the differences between the financial reporting carrying values and the tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. A valuation allowance is recognized to reduce net deferred tax assets to amounts that management believes are more likely than not expected to be realized.

The Company adopted the provisions of FIN 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109, (FIN 48) effective February 4, 2007. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in an income tax return. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures.

As a result of the implementation of FIN 48, the Company did not recognize a liability for unrecognized tax benefits or reverse any accruals for uncertain tax positions previously recorded, and accordingly, was not required to record any cumulative effect adjustment to beginning of year retained earnings. As of both the date of adoption and February 2, 2008, there was no liability for income tax associated with unrecognized tax benefits.

The Company classifies interest related to unrecognized tax benefits as well as any related penalties in operating expenses in its consolidated statements of operations, which is consistent with the recognition of these items in prior reporting periods. As of the date of adoption, the Company was not required to have an accrual for the payment of interest and penalties. No accrual for interest and penalties related to uncertain tax positions was required as of February 2, 2008.

The Company operates stores throughout the United States and Puerto Rico, and as a result, files income tax returns in the United States federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities. The statute of limitations for examinations by the Internal Revenue Service has expired for years ending on and before January 31, 2005.

State and foreign income tax returns are generally subject to examination for a period of three to five years after filing of the respective return. The state impact of any federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states. The Company is not currently under examination in any state or foreign jurisdictions.

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Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share includes, in periods in which they are dilutive, the dilutive effect of those common stock equivalents where the average market price of the common shares exceeds the exercise prices for the respective years.

Basic and diluted net income per common share are computed as follows:

| | FISCAL YEAR | | |
|--|-----------------|---------------------|----------------------|
| | 2007 | 2006 | 2005 |
| Net income- basic | \$ 5,730 | \$ 4,389,662 | \$ 15,259,017 |
| Add: interest on convertible note | | 465,798 | 371,458 |
| Net income- diluted | \$ 5,730 | \$ 4,855,460 | \$ 15,630,475 |
| Denominator: | | | |
| Weighted average number of shares for basic net income per share | 3,058,797 | 3,000,471 | 2,949,146 |
| Options to purchase common stock | | 60,975 | 69,890 |
| Convertible note | | 444,444 | 444,444 |
| Denominator for dilutive net income per share | 3,058,797 | 3,505,890 | 3,463,480 |
| Basic net income per common share | \$ | \$ 1.46 | \$ 5.17 |
| Diluted net income per common share | \$ | \$ 1.38 | \$ 4.51 |

All common stock equivalents are excluded from the computation of diluted net income per share in fiscal year 2007 because the result is antidilutive. Excluded from the above computations of weighted-average shares for diluted net income per share were options to purchase 4,504 shares and 5,256 shares of common stock for fiscal years 2006 and 2005 respectively, because the exercise price was greater than the average market price of the Company's common stock during the period and therefore, the effect was antidilutive. The convertible note was issued in December 2004. See further discussion at Note 7.

ASSET IMPAIRMENT

The carrying value of long-lived assets is evaluated whenever events or changes in circumstances indicate that the carrying values of such assets may be impaired. An evaluation of recoverability is performed by comparing the carrying values of the assets to projected future cash flows in addition to other quantitative and qualitative analyses. Upon indication that the carrying values of such assets may not be recoverable, the Company recognizes an impairment loss. The impairment loss is determined based on the difference between the net book value and the fair value of the assets. The estimated fair value is based on anticipated discounted future cash flows. Any impairment is charged to operations in the period in which it is identified. Property and equipment assets are grouped at the lowest level for which there are identifiable cash flows when assessing impairment. Cash flows for retail assets are identified at the individual store level.

SHARE BASED COMPENSATION

The Company has two stock option plans which provide for share-based awards to its employees and directors (collectively, the Plans). Under the Plans, the Company has reserved approximately 1,000,000 shares of common stock, of which approximately 590,000 options have been granted and 148,000 options are outstanding. All stock options have an exercise price that is equal to the fair market value of the Company's stock on the date the options were granted. The term of the stock option awards is ten years from the date of grant. All options are fully vested.

Effective January 29, 2006, the beginning of the Company's first fiscal quarter of 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment* (SFAS 123R), using the modified prospective transition method and began recording compensation expense associated with stock options. SFAS 123R requires companies to

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recognize in the statement of operations the cost of employee services received in exchange for awards of equity instruments based on the grant date fair value of those awards (with limited exceptions). Prior to the adoption of SFAS 123R, the Company accounted for stock-based employee compensation using the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* . Accordingly, compensation expense had only been recorded in the consolidated financial statements for any stock options granted below fair market value of the underlying stock as of the date of grant.

The modified prospective transition method requires that share-based compensation expense be recorded for (i) all new stock options granted on or after January 29, 2006 based on the grant date fair value determined under the provisions of SFAS 123R and (ii) all unvested stock options granted prior to January 29, 2006 based on the grant date fair value as determined under the provisions of SFAS 123. Results for prior periods have not been restated, as provided for under the modified prospective transition method.

The Company recognized pre-tax compensation expense of approximately \$71,000 and \$64,000 respectively, in the consolidated statements of operations for stock options granted and vested during fiscal year 2007 and 2006, respectively. All of the stock option compensation expense was recorded as a component of selling, general and administrative expenses in the Company s consolidated statements of operations.

The following table illustrates the pro forma effects on net income and net income per common share in fiscal year 2005 had compensation expense been recognized based upon the estimated fair value on the grant date of stock options in accordance with SFAS 123 (in thousands except per share amounts).

| | FISCAL YEAR 2005 |
|---|-----------------------------|
| Net income, as reported | \$ 15,259 |
| Add: Total stock-based employee compensation expense included in reported net income, net of tax | |
| Deduct: Total stock-based employee compensation expense determined under fair market value based method, net of tax | (883) |
| Proforma net income | \$ 14,376 |
| Net income per common share-basic: | |
| As reported | \$ 5.17 |
| Stock based compensation | (0.30) |
| Proforma | \$ 4.87 |
| Net income per common share-diluted: | |
| As reported | \$ 4.51 |
| Stock based compensation | (0.26) |
| Proforma | \$ 4.25 |

Pro-forma disclosure for fiscal year 2007 and 2006 are not presented above because the share-based compensation amounts are recognized in the accompanying consolidated financial statements.

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The fair value for these stock options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

| | FISCAL YEAR | | |
|---------------------------------|-------------|-------|-------|
| | 2007 | 2006 | 2005 |
| Expected life (years) | 5 | 5 | 7 |
| Expected stock price volatility | 206% | 173% | 164% |
| Risk-free interest rates | 2.82% | 4.39% | 3.88% |
| Expected dividend yield | 0% | 0% | 0% |

The expected life of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. The expected stock price volatility is estimated using the historical volatility of the Company's stock. The risk-free interest rate is based on the implied yield available on U.S. Treasury zero coupon issues with a term equal to the option's expected life. The Company has not paid dividends in the past and does not intend to in the foreseeable future.

For the purposes of the proforma presentation of employee share-based compensation expense, the Company currently amortizes the expense over the related vesting period. The weighted average estimated fair values of options granted during fiscal year 2007, 2006, and 2005 were \$23.57, \$21.42 and \$12.09 per share, respectively. The fair value of options that vested during fiscal years 2007, 2006 and 2005 was approximately \$71,000, \$36,000 and \$1,338,000 respectively.

PRE-OPENING EXPENSES

Pre-opening expenses related to new stores are expensed as incurred.

SHIPPING AND HANDLING FEES AND COSTS

Income generated from shipping and handling fees is classified as revenues. The Company classifies the costs related to shipping and handling as cost of goods sold. The income and cost associated with shipping and handling when combined is immaterial.

ADVERTISING COSTS

Advertising expense for the fiscal years 2007, 2006 and 2005 was approximately \$2,771,000, \$2,679,000 and \$1,650,000, respectively, and is charged to expense when incurred. There were no cooperative advertising amounts received from vendors for fiscal years 2007, 2006 and 2005.

RENT EXPENSE

Perfumania leases retail stores under operating leases. Minimum rental expenses are recognized over the term of the lease on a straight-line basis. For purposes of recognizing minimum rental expenses, the Company uses the date when possession of the leased space is taken from the landlord, which includes a construction period of approximately two months prior to store opening. For tenant improvement allowances and rent holidays, the Company records a deferred rent liability in accrued expenses on the consolidated balance sheets and amortizes the deferred rent over the terms of the leases as reductions to rent expense on the consolidated statements of operations. For scheduled rent escalation clauses during the lease terms or for rental payments commencing at a date other than the date of initial occupancy, the Company records minimum rental expenses on a straight-line basis over the terms of the leases on the consolidated statements of operations.

Certain leases provide for contingent rents, which are primarily determined as a percentage of gross sales in excess of specified levels and are not measurable at inception. The Company records a contingent rent liability in accrued expenses on the consolidated balance sheets and the corresponding rent expense when specified levels have been achieved or when management determines that achieving the specified levels during the fiscal year is probable.

RECENT ACCOUNTING PRONOUNCEMENTS

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities* an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 requires enhanced disclosures regarding derivatives and hedging activities, including: (a) the manner

in which an entity uses derivative instruments; (b) the manner in which derivative instruments and related hedged items are accounted for under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative*

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Instruments and Hedging Activities ; and (c) the effect of derivative instruments and related hedged items on an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. As SFAS 161 relates specifically to disclosures, it will have no impact on the Company's results of operations, financial position and cash flows.

In December 2007, the FASB issued SFAS 141(R), *Business Combinations* (SFAS 141(R)). SFAS 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, the goodwill acquired, and any noncontrolling interest in the acquiree. This statement also establishes disclosure requirements to enable the evaluation of the nature and financial effect of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company is in the process of evaluating the effect that the adoption of SFAS 141(R) will have on its results of operations, financial position, and cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51.* (SFAS 160). SFAS 160 amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. The Company is in the process of evaluating the effect that the adoption of SFAS 160 will have on its results of operations, financial position, and cash flows.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115.* (SFAS). SFAS 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective for fiscal 2008. The Company concluded that the adoption of SFAS 159 will not have a material effect on its results of operations, financial position and cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements and, accordingly, does not require any new fair value measurements. SFAS 157 is effective for the first interim period beginning in fiscal 2008 for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis in financial statements. In November 2007, the FSAB provided a one year deferral for the implementation of SFAS 157 for other nonfinancial assets and liabilities. The Company does not expect the adoption of SFAS 157 to have a material effect on its results of operations, financial position and cash flows.

NOTE 3 RESTATEMENT

Subsequent to the issuance of the Company's 2006 financial statements, management identified errors in the accounting for operating leases and the period of amortization of leasehold improvements.

Under GAAP, rent expense is amortized on a straight-line basis over the term of the lease. In prior periods, the Company had determined that the term of the lease begins on the commencement date of the lease, which generally coincides with the store opening date. Management has re-evaluated FASB Technical Bulletin No. 85-3, *Accounting for Operating Leases with Scheduled Rent Increases* and other guidance provided by the SEC and determined that the lease term for amortization purposes should commence on the date the Company takes physical possession of the leased space to commence construction of leasehold improvements, which is generally two months prior to a store opening date. The Company has restated its previously reported financial statements in connection with its accounting for rent expense. Rent expense is included in selling, general and administrative expenses on the Company's consolidated statements of operations.

Management has also reviewed its leasehold improvements to ensure amortization over the shorter of their economic lives or their lease term. In prior periods, in determining the lease terms, in addition to the initial term, the Company had included one anticipated renewal term even if the lease did not have a stated renewal option. The Company has adjusted its lease terms for purposes of calculating amortization of leasehold improvements to include a renewal term only if that renewal option is specified in the lease agreement and that exiting the lease after the initial lease term would result in economic loss and therefore normally management anticipates exercising the respective renewal option.

The restatement resulted in a decrease in net income of \$0.1 million in fiscal year 2006, an increase in net income of \$1.0 million in fiscal year 2005 and a decrease in net income of \$2.7 million for all years prior to fiscal year 2005, with a corresponding increase to the accumulated deficit of as of January 29, 2005. The majority of the adjustments relate to periods prior to fiscal year 2005.

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The following is a summary of the effects of the restatement to the Company's Consolidated Financial Statements.

| | Consolidated Statements of Operations | | |
|---|--|--------------------|--------------------|
| | As previously reported | Adjustments | As restated |
| Fiscal year ended February 3, 2007 | | | |
| Selling general and administrative expenses | \$ 88,699,388 | \$ 304,479 | \$ 89,003,867 |
| Depreciation and amortization | 4,863,319 | (66,372) | 4,796,947 |
| Total operating expenses | 93,562,707 | 238,107 | 93,800,814 |
| Income from operations | 10,366,914 | (238,107) | 10,128,807 |
| Income before income taxes | 5,872,173 | (238,107) | 5,634,066 |
| Income tax (provision) benefit | (1,350,243) | 105,839 | (1,244,404) |
| Net income | 4,521,930 | (132,268) | 4,389,662 |
| Basic net income per common share | \$ 1.51 | \$ (0.05) | \$ 1.46 |
| Diluted net income per common share | \$ 1.42 | \$ (0.04) | \$ 1.38 |
| Fiscal year ended January 28, 2006 | | | |
| Selling general and administrative expenses | \$ 80,839,776 | \$ 165,827 | \$ 81,005,603 |
| Depreciation and amortization | 5,155,645 | (325,274) | 4,830,371 |
| Total operating expenses | 85,995,421 | (159,447) | 85,835,974 |
| Income from operations | 10,505,738 | 159,447 | 10,665,185 |
| Income before income taxes | 6,628,262 | 159,447 | 6,787,709 |
| Income tax (provision) benefit | 7,637,000 | 834,308 | 8,471,308 |
| Net income | 14,265,262 | 993,755 | 15,259,017 |
| Basic net income per common share | \$ 4.84 | \$ 0.33 | \$ 5.17 |
| Diluted net income per common share | \$ 4.23 | \$ 0.28 | \$ 4.51 |

| | Consolidated Balance Sheet | | |
|--|-----------------------------------|--------------------|--------------------|
| | As previously reported | Adjustments | As restated |
| February 3, 2007 | | | |
| Property and equipment, net | \$ 30,213,222 | \$ (1,966,789) | \$ 28,246,433 |
| Deferred tax asset: non-current | 6,288,032 | 940,147 | 7,228,179 |
| Total assets | 125,748,825 | (1,026,642) | 124,722,183 |
| Accrued expenses and other liabilities | 7,502,546 | 801,679 | 8,304,225 |
| Total current liabilities | 75,625,357 | 801,679 | 76,427,036 |
| Total liabilities | 88,178,272 | 801,679 | 88,979,951 |
| Accumulated deficit | (32,961,790) | (1,828,321) | (34,790,111) |
| Total shareholders' equity | 37,570,553 | (1,828,321) | 35,742,232 |
| Total liabilities and shareholders' equity | \$ 125,748,825 | \$ (1,026,642) | \$ 124,722,183 |

NOTE 4 NON-CASH TRANSACTIONS

Supplemental disclosures of non-cash investing and financing activities:

| NON-CASH TRANSACTIONS | FISCAL YEAR | | |
|--|--------------------|-------------|-------------|
| | 2007 | 2006 | 2005 |
| Equipment and building acquired under capital leases | \$ | \$ | \$ 259,430 |
| Compensation cost for President and Chief Executive Officer contributed to capital | | | 406,000 |
| Accounts payable for property and equipment | 413,767 | 135,369 | |

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Property and equipment consisted of:

| | Estimated Useful Lives | | |
|---|------------------------|------------------|-----------------------------------|
| | February 2, 2008 | February 3, 2007 | (In Years) |
| Furniture, fixtures and equipment | \$ 32,388,238 | \$ 30,146,067 | 5-7 |
| Leasehold improvements | 44,362,343 | 35,767,650 | shorter of 10 years or lease term |
| Equipment under capital leases | 330,293 | 330,293 | shorter of 5 years or lease term |
| Building under capital lease | 8,188,945 | 8,188,945 | 15 |
| | 85,269,819 | 74,432,955 | |
| Less: | | | |
| Accumulated depreciation and amortization | (48,681,884) | (46,186,522) | |
| | \$ 36,587,935 | \$ 28,246,433 | |

Depreciation and amortization expense for fiscal years 2007, 2006, and 2005 was \$6,196,880, \$4,796,947 and \$4,689,123, respectively. Accumulated depreciation for building and equipment under capital leases was \$2,806,766 and \$2,151,657 as of February 2, 2008 and February 3, 2007, respectively.

See Note 12 for further discussion of capital leases.

NOTE 6 - RELATED PARTY TRANSACTIONS

Glenn and Stephen Nussdorf (the Nussdorfs) own an aggregate 1,113,144 shares or approximately 36% of the total number of shares of the Company's common stock as of February 2, 2008, excluding shares issuable upon conversion of the Convertible Note discussed below in Note 6. Stephen Nussdorf has served as the Company's Chairman of the Board since February 2004.

The Nussdorfs are officers and principals of Model and its affiliate, Quality King Distributors, Inc. (Quality King) and their subsidiaries, including Quality King Fragrances, Inc. Model is a diversified wholesale and retail fragrance company and Quality King distributes pharmaceuticals and health and beauty care products. The Company's President and Chief Executive Officer, Michael W. Katz is an executive of Model and Quality King and the Company's principal shareholders, Stephen Nussdorf, the Chairman of the Company's Board of Directors and Glenn Nussdorf, his brother, are shareholders and executives of Model and Quality King.

Sales To and Purchases From Affiliated Companies

During fiscal year 2007, the Company purchased approximately \$32,138,000 of merchandise from Model and its subsidiaries, representing approximately 15% of the Company's total purchases, and sold approximately \$57,715,000 of different merchandise to Model and its subsidiaries, which represented substantially all of the Company's wholesale sales. There were approximately \$32,385,000 and \$30,547,000 of purchases from Model and its subsidiaries and approximately \$13,624,000 and \$17,845,000 of merchandise sales to Model and its subsidiaries during fiscal years 2006 and 2005, respectively. The wholesale sales made to Model and its subsidiaries result from the Company's supplier relationships and its ability to obtain certain merchandise at better prices and in greater quantities than Model and its subsidiaries are able to achieve. The amounts due to Model and its subsidiaries at February 2, 2008 and February 3, 2007, were approximately \$36,124,000 and \$16,897,000 respectively. Accounts payable due to Model and its subsidiaries are non-interest bearing and are included in the accounts payable-affiliates in the accompanying consolidated balance sheets.

Glenn Nussdorf beneficially owns approximately 12% of the outstanding common stock of Parlux Fragrances, Inc. (Parlux). In February 2007, Mr. Nussdorf reached an agreement with Parlux which called for equal representation in Parlux's Board of Directors by the then current independent directors and Mr. Nussdorf's nominees. Accordingly, Mr. Nussdorf's three nominees were appointed to the Parlux Board, and one of these Board members currently serves as Parlux's Chief Executive Officer.

Purchases of merchandise from Parlux amounted to approximately \$44,743,000, \$17,644,000 and \$23,004,000 in fiscal years 2007, 2006 and 2005, representing approximately 21%, 12% and 18%, respectively, of the Company's total purchases. In fiscal year 2006, Parlux sold all 378,102 shares of the Company's common stock that it had previously owned to an unrelated third party. The amount due to Parlux on February 2, 2008 and February 3, 2007, was approximately \$12,526,000 and \$7,213,000, respectively. Accounts payable due to Parlux are non-interest bearing. Purchases from related parties are generally payable in 90 days, however,

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due to the seasonality of the Company's business, these terms are generally extended. Related party accounts are historically brought closer to terms at the end of the holiday season, however, we are dependent upon these extended terms for much of our liquidity during the year.

Merger Agreement With Model and Other Arrangements

As reported in the Company's Form 8-K filed with the SEC on December 21, 2007, the Company entered into an Agreement and Plan of Merger (the Merger Agreement) with Model, a New York corporation controlled by the family of Glenn and Stephen Nussdorf, principal shareholders of the Company, on December 21, 2007. Model is a diversified wholesale and retail fragrance company. Stephen Nussdorf is the Chairman of our Board of Directors, and Michael W. Katz, our President and Chief Executive Officer, is an executive of Model. Pursuant to the terms of the Merger Agreement, Model will be merged into a newly formed wholly-owned subsidiary of the Company in exchange for the issuance of 5,900,000 shares of the Company's common stock and warrants to acquire an additional 1,500,000 shares of the Company's common stock at an exercise price of \$23.94. The warrants will have a 10-year term, will not be exercisable for the first three years and will not be transferable, with limited exceptions.

The Merger Agreement was reached after extensive negotiations between Model and a special committee comprised of the independent Board members of the Company, which retained independent counsel and financial advisors. The special committee received an opinion from Financo, Inc. that, as of the date of the Merger Agreement and subject to various assumptions and qualifications set forth therein, the consideration to be paid by the Company in the merger is fair to the shareholders of the Company (other than shareholders of the Company who own or whose affiliates own securities of Model) from a financial point of view.

The Merger Agreement also requires Model to refinance debt owed by Model to its affiliate, Quality King. The refinancing is to be through a \$50 million three-year term loan from trusts for the benefit of Glenn and Stephen Nussdorf and their families and, if needed, a transfer of inventory from Model to Quality King to pay any remaining balance. The new loan will be subordinated to the new secured credit facility described below.

The consummation of the contemplated Merger is subject to certain conditions, including approval of a majority of the votes cast at a meeting of shareholders of the Company and the availability of a new \$280 million secured credit facility to replace the Company's and Model's existing third party credit facilities.

Included in selling, general and administrative expenses on the Company's consolidated statement of operations for fiscal year 2007 are \$1.2 million of expenses related to the Merger. These expenses consist primarily of financial advisory, legal and due diligence fees.

Following the contemplated Merger, the Nussdorf's, who currently own 36% of the Company's outstanding common stock, would own approximately 51% of the Company's outstanding common stock. Giving effect to the conversion of our \$5 million subordinated convertible note currently held by them and the exercise of the warrants to be issued to them in the transaction, but not assuming the exercise of any outstanding options held by the Company's officers and directors, they would own approximately 58% of the Company's common stock.

In addition, the Company's Board approved changing the Company's name to Perfumania Holdings, Inc., subject to shareholder approval.

On March 12, 2008, the Company filed a preliminary proxy statement with the SEC discussing the Merger Agreement and the related required shareholder approvals, including the issuance of the additional shares of the Company's common stock pursuant to the Merger Agreement and the related amendments to the Company's articles of incorporation.

On August 2, 2007, the Company entered into an Information Technology Services Agreement (the Services Agreement) with Model and its subsidiaries, whereby among other services, the Company will manage and monitor the IT systems of Model in exchange for a monthly service fee of \$25,000. The Services Agreement terminates 30 days after the effective date of the merger discussed above, or if such merger offer is not consummated on or before December 31, 2008, either party may terminate 30 days after providing written notice of termination. During fiscal year 2007, the Company recorded income of \$150,000 related to this Services Agreement which is included as a reduction to selling, general and administrative expenses on the consolidated statement of operations for fiscal year 2007.

Table of Contents**NOTE 7 - BANK LINE OF CREDIT AND NOTES PAYABLE**

The bank line of credit and notes payable, all of which is classified as current as of February 2, 2008, consist of the following:

| | February 2, 2008 | February 3, 2007 |
|--|------------------|------------------|
| Bank line of credit, interest payable monthly, secured by a pledge of substantially all of Perfumania's assets | \$ 32,840,872 | \$ 26,919,115 |
| Subordinated convertible note payable-affiliate | \$ 5,000,000 | \$ 5,000,000 |

Perfumania's senior secured credit facility provides for borrowings of up to \$60 million, depending on the Company's levels of eligible inventories. Advances under the line of credit are based on a formula of eligible inventories and bear interest at a floating rate ranging from (a) prime to prime plus 1.25% or (b) LIBOR plus 2.5% to 3.75% depending on a financial ratio test. As of February 2, 2008, \$32.8 million was outstanding under the line of credit and \$18.1 million was available to support normal working capital requirements and other general corporate purposes based upon our eligible borrowing base, net of the restrictions concerning minimum undrawn availability discussed below. Advances are secured by a first lien on all assets of Perfumania. The credit facility contains limitations on additional borrowings, capital expenditures and other items, and contains various covenants including a fixed charge coverage ratio, a leverage ratio and capital expenditure limits as defined. The credit facility also prohibits the Company from paying cash dividends. In June 2007, the minimum undrawn availability as defined was amended so that Perfumania is required to maintain at all times, a minimum undrawn availability of not less than \$5,000,000, and shall maintain a monthly average undrawn availability, as defined, of not less than \$7,500,000. In May 2008, the fixed charge covenant and the covenant concerning the limitation on capital expenditures were amended with an effective date of February 1, 2008. As a result of these modifications, Perfumania was in compliance with all covenant requirements as of February 2, 2008.

The credit facility expired on May 12, 2008. In May 2008, the Company obtained a ninety day extension of the credit facility to August 11, 2008. As discussed in Note 6, the Merger with Model is subject to a number of terms, one of which includes the requirement that the Company and Model obtain a commitment for asset-based loans and term debt facilities in amounts and on terms that are substantially similar to those contemplated by a previous commitment that was obtained in August 2007. That commitment provided for replacement senior credit facilities for us and Model in an aggregate amount of up to \$280 million, to be established upon the closing of the Merger. That commitment expired by its terms in November 2007. A comparable commitment on substantially similar terms and amounts was obtained from the same lender on May 16, 2008.

Failure of the Merger with Model to close prior to the expiration of the credit facility on August 11, 2008 will result in the Company having to seek an additional extension of this facility, or to obtain an alternative source of financing. Management of the Company believes that alternative financing sources on terms acceptable would be available, however there is no guarantee that such will occur.

In March 2004, the Nussdorfs provided a \$5,000,000 subordinated secured demand loan to Perfumania. The demand loan required quarterly interest payments at the prime rate plus 1%. There were no prepayment penalties and the loan was subordinate to all bank related indebtedness. On December 9, 2004, the Company issued a Subordinated Convertible Note (the Convertible Note) in exchange for the \$5,000,000 subordinated secured demand loan. The Convertible Note bears interest at the prime rate plus 1%, requires quarterly interest payments and is secured by a security interest in the Company's assets pursuant to a Security Agreement, by and among the Company and the Nussdorfs. There are no prepayment penalties and the Convertible Note is subordinate to all bank related indebtedness. The Convertible Note was originally payable in January 2007 however it was modified in January 2006 to extend the due date to January 2009. The Note allows the Nussdorfs to convert the Convertible Note into shares of the Company's common stock at a conversion price of \$11.25, which equaled the closing market price of the Company's common stock on the date of the exchange.

NOTE 8 - IMPAIRMENT OF ASSETS

The Company recognized non-cash impairment charges relating to its retail locations that were either closed or identified for closure of approximately \$0.3 million, \$0.2 million and \$0.2 million during fiscal years 2007, 2006 and 2005, respectively. These charges were determined based on the difference between the carrying amounts of the assets, representing primarily fixtures and

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leasehold improvements, at particular store locations and the fair values of the assets on a store-by-store basis. The estimated fair values are based on anticipated future cash flows discounted at a rate commensurate with the risk involved. These impairment losses are included in selling, general and administrative expenses in the accompanying consolidated statements of operations.

NOTE 9 - INCOME TAXES

The income tax (provision) benefit is comprised of the following amounts:

| | FISCAL YEAR ENDED | | |
|---------------------|--------------------------|-------------------------|-------------------------|
| | February 2, 2008 | February 3, 2007 | January 28, 2006 |
| Current: | | | |
| Federal | \$ (44,668) | \$ (90,000) | \$ (200,000) |
| State | (108,010) | (91,000) | (200,000) |
| | (152,678) | (181,000) | (400,000) |
| Deferred: | | | |
| Federal | (873,558) | (1,710,240) | 7,946,273 |
| State | (101,744) | (199,164) | 925,035 |
| Foreign | 167,913 | 846,000 | |
| | (807,389) | (1,063,404) | 8,871,308 |
| Income tax | | | |
| (provision) benefit | \$ (960,067) | \$ (1,244,404) | \$ 8,471,308 |

The income tax provision differs from the amount obtained by applying the statutory Federal income tax rate to pretax income as follows:

| | FISCAL YEAR ENDED | | |
|---------------------------------------|--------------------------|-------------------------|-------------------------|
| | February 2, 2008 | February 3, 2007 | January 28, 2006 |
| Expense at federal statutory rates | \$ (328,371) | \$ (1,915,582) | \$ (2,307,821) |
| Non-deductible expenses | (332,938) | (23,156) | (18,000) |
| Change in valuation allowance | | 2,730,392 | 10,554,746 |
| Adjustment to net operating loss | | (1,763,853) | |
| Other | (298,758) | (272,205) | 242,383 |
| Income tax (provision) benefit | \$ (960,067) | \$ (1,244,404) | \$ 8,471,308 |

Net deferred tax assets reflect the tax effect of the following differences between financial statement carrying amounts and tax basis of assets and liabilities as follows:

| | FISCAL YEAR ENDED | |
|---|--------------------------|-------------------------|
| | February 2, 2008 | February 3, 2007 |
| Assets: | | |
| Net operating loss & tax credit carryforwards | \$ 359,964 | \$ 1,882,860 |
| Puerto Rican net operating loss carryforwards | 1,013,472 | 845,558 |
| Capital loss carryforward | 1,571,773 | 1,571,773 |
| Inventories | 1,003,441 | 946,663 |

| | | |
|----------------------------------|---------------------|----------------------|
| Property and equipment | 5,763,844 | 5,323,697 |
| Goodwill | 40,459 | 143,643 |
| Self insured reserves and other | 1,061,194 | 907,342 |
| Total deferred tax assets | 10,814,147 | 11,621,536 |
| Valuation allowance | (1,571,773) | (1,571,773) |
| Net deferred tax assets | \$ 9,242,374 | \$ 10,049,763 |

In evaluating the reasonableness of the valuation allowance, management assesses whether it is more likely than not that some portion, or all, of the deferred tax assets will not be realized. Ultimately, the realization of deferred tax assets is dependant upon the generation of future taxable income during those periods in which temporary differences become deductible and/or credits can be utilized. To this end, management considers the level of historical taxable income, the scheduled reversal of deferred tax assets and

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projected future taxable income. Based on these considerations, and the carryforward availability of the deferred tax assets, management believes it is more likely than not that the Company will realize the benefit of the deferred tax assets, except for capital loss carryforwards. The Company's United States and Puerto Rican net operating loss carryforwards begin to expire in 2019 and 2009, respectively.

The Company previously recorded a full valuation allowance related to the deferred tax assets of its Puerto Rican subsidiary, as realization of these assets was not more likely than not. In fiscal year 2006, management determined that it is more likely than not that these assets will be realized. As a result, the reversal of the valuation allowance on these deferred tax assets of approximately \$2.7 million was reflected as a benefit in the tax provision for fiscal year 2006. In addition, in fiscal year 2006, the Company recorded an increase to the net operating losses of its Puerto Rican subsidiary of approximately \$1.8 million as a result of a Puerto Rico tax audit that was finalized in 2007.

Prior to fiscal year 2005, the Company previously recorded a full valuation allowance related to its deferred tax assets as realization of these assets was not more likely than not. In fiscal year 2005, management determined that it was more likely than not that certain of the Company's deferred tax assets, primarily related to its United States operations, would be realized. As a result, the reversal of the valuation allowance of approximately \$9.7 million was reflected as a benefit in the tax provision for fiscal year 2005. In addition, the reversal of approximately \$2.2 million of valuation allowance related to the exercise of stock options was recorded in the consolidated statement of changes in shareholders equity in fiscal year 2005.

As a result of the implementation of FIN 48 during the first quarter of fiscal year 2007, the Company did not recognize a liability for unrecognized tax benefits or reverse any accruals for uncertain tax positions previously recorded, and accordingly, was not required to record any cumulative effect adjustment to beginning of year retained earnings. As of both the date of adoption and during fiscal year 2007, there was no liability for income tax associated with unrecognized tax benefits.

NOTE 10 - SHAREHOLDERS' EQUITY**PREFERRED STOCK**

The Company's Articles of Incorporation authorize the issuance of up to 1,000,000 shares of preferred stock. The preferred stock may be issued from time to time at the discretion of the Board of Directors without shareholders' approval. The Board of Directors is authorized to issue these shares in different series and, with respect to each series, to determine the dividend rate, and provisions regarding redemption, conversion, liquidation preference and other rights and privileges. As of February 2, 2008, no preferred stock had been issued.

TREASURY STOCK

From time to time, the Company's Board of Directors has approved the repurchase of the Company's common stock. As of February 2, 2008, the Company had repurchased approximately 898,000 shares of common stock for approximately \$8.6 million, all of which are held as treasury shares. There were no repurchases during fiscal years 2007, 2006 or 2005.

STOCK OPTION PLANS

The Company currently has two plans which provide for equity-based awards to its employees and directors. Pursuant to the 2000 Stock Option Plan (the "Stock Option Plan") and the 2000 Directors Stock Option Plan (the "Directors Plan") (collectively, the "Plans"), 375,000 shares and 30,000 shares of common stock, respectively, were initially reserved for issuance upon exercise of options under the Plans. Additionally, the number of shares available under the Stock Option Plan automatically increases each year by an amount equal to 3% of the shares of common stock of the Company outstanding at the end of the immediate preceding year. The Company's Board of Directors, or a committee thereof, administers and interprets the Stock Option Plan. The Stock Option Plan provides for the granting of both incentive stock options (as defined in Section 422A of the Internal Revenue Code) and non-statutory stock options. Options can be granted under the Stock Option Plan on such terms and at such prices as determined by the Board, except that the per share exercise price of options will not be less than the fair market value of the common stock on the date of grant. Only non-employee directors are eligible to receive options under the Directors Plan. The Directors Plan provides for an automatic grant of an option to purchase 500 shares of common stock upon election as a director of the Company and an automatic grant of 1,000 shares of common stock upon such person's re-election as a director of the Company, in both instances, at an exercise price equal to the fair value of the common stock on the date of grant.

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Options granted under the Stock Option Plan are exercisable after the period or periods specified in the option agreement, and options granted under the Directors Plan are exercisable immediately. Options granted under the Plans are not exercisable after the expiration of 10 years from the date of grant. A summary of the Company's option activity, and related information for the fiscal year ended February 2, 2008 is as follows:

| | Shares | 2007 Weighted Average Exercise Price |
|-----------------------------------|----------------|--|
| Outstanding at beginning of year | 149,026 | \$ 12.39 |
| Granted | 5,296 | 24.05 |
| Exercised | (6,626) | 6.50 |
| Cancelled | | 3.52 |
| Outstanding at end of year | 147,696 | \$ 12.80 |

Options exercisable at end of year 147,696 \$ 12.80

The aggregate intrinsic value of options exercised during fiscal years 2007, 2006 and 2005 was approximately \$86,000, \$909,000 and \$216,000, respectively. The aggregate intrinsic value for fully vested options as of February 2, 2008 was approximately \$1,732,000.

The following table summarizes information about stock options outstanding at February 2, 2008:

| RANGE OF EXERCISE PRICES | NUMBER OUTSTANDING | OPTIONS OUTSTANDING | | OPTIONS EXERCISABLE | |
|--------------------------|-----------------------|--|---|-----------------------|---|
| | | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life in years | NUMBER EXERCISABLE | Weighted Average Remaining Exercise Price |
| \$2.00 - \$12.52 | 35,690 | \$ 10.01 | 2.19 | 35,690 | \$ 10.01 |
| \$12.99 - \$12.99 | 100,000 | 12.99 | 7.40 | 100,000 | 12.99 |
| \$13.85 - \$22.49 | 9,006 | 18.03 | 6.92 | 9,006 | 18.03 |
| \$24.05 - \$24.05 | 3,000 | 24.05 | 9.99 | 3,000 | 24.05 |
| | 147,696 | \$ 12.80 | 6.17 | 147,696 | \$ 12.80 |

NOTE 11 - EMPLOYEE BENEFIT PLANS

The Company has a 401(k) Savings and Investment Plan (the Plan). Pursuant to such Plan, participants may make contributions to the Plan up to a maximum of 20% of total compensation or the maximum limits allowable under the Internal Revenue Code, whichever is less, and the Company, at its discretion, may match such contributions to the extent of 25% of the first 6% of a participant's contribution. The Company's matching contributions vest over a 4-year period. In addition to matching contributions, the Company may make additional contributions on a discretionary basis in order to comply with certain Internal Revenue Code regulations prohibiting discrimination in favor of highly compensated employees. The Company did not match contributions during fiscal years 2007, 2006 and 2005.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

The Company is self-insured for employee medical benefits under the Company's group health plan. The Company maintains stop loss coverage for individual medical claims in excess of \$90,000 and for annual Company medical claims which exceed approximately \$3.2 million in the aggregate. While the ultimate amount of claims incurred are dependent on future developments, in management's opinion, recorded accruals are adequate to cover the future payment of claims incurred as of February 2, 2008. However, it is possible that recorded accruals may not be adequate to cover the future payment of claims. Adjustments, if any, to estimates recorded resulting from ultimate claim payments will be reflected in operations in the periods in which such adjustments are determined. The self-insurance accrual at February 2, 2008 and February 3,

2007 was approximately \$219,000 and \$271,000, respectively, which is included in accrued expenses and other liabilities in the accompanying consolidated balance sheets.

The Company leases space for its retail stores. The lease terms vary from month to month leases to ten year leases, in some cases with options to renew for longer periods. Various leases contain clauses, which adjust the base rental rate by the prevailing Consumer Price Index, as well as requiring additional contingent rent based on a percentage of gross sales in excess of a specified amount.

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Rent expense is as follows:

| | FISCAL YEAR | | |
|--------------------|----------------------|----------------------|----------------------|
| | 2007 | 2006 | 2005 |
| Minimum rentals | \$ 19,255,212 | \$ 16,812,743 | \$ 14,800,858 |
| Contingent rentals | 1,493,294 | 1,384,501 | 1,449,216 |
| Total | \$ 20,748,506 | \$ 18,197,244 | \$ 16,250,074 |

Future minimum lease commitments under non-cancelable operating leases at February 2, 2008 (excluding future payments for maintenance, insurance and taxes to which the Company is obligated) are as follows:

| FISCAL YEAR | |
|--|-----------------------|
| 2008 | \$ 19,129,081 |
| 2009 | 17,271,125 |
| 2010 | 15,884,482 |
| 2011 | 14,002,190 |
| 2012 | 11,170,328 |
| Thereafter | 32,914,134 |
| Total future minimum lease payments | \$ 110,371,340 |

The Company's capitalized leases consist of a corporate office and distribution facility in Sunrise, Florida, as well as computer hardware and software. The lease for the corporate office and distribution facility is for approximately 14 years with monthly rent ranging from approximately \$81,000 to \$104,000 during the term of the lease. The lease terms for the computer hardware and software vary from one to three years. The following is a schedule of future minimum lease payments under capital leases together with the present value of the net minimum lease payments, at February 2, 2008:

| FISCAL YEAR | |
|--|---------------------|
| 2008 | \$ 1,209,850 |
| 2009 | 1,231,779 |
| 2010 | 1,239,766 |
| 2011 | 1,326,630 |
| 2012 | 1,326,631 |
| Thereafter | 6,522,606 |
| Total future minimum lease payments | 12,857,262 |
| Less: Amount representing interest | (5,311,618) |
| Present value of minimum lease payments | 7,545,644 |
| Less: Current portion | (355,376) |
| | \$ 7,190,268 |

Depreciation expense relating to capital leases is included in depreciation and amortization expense in the accompanying consolidated statements of operations and totaled approximately \$655,000, \$676,000 and \$687,000 in fiscal years 2007, 2006 and 2005, respectively.

The Company is involved in various legal proceedings in the ordinary course of business. Management cannot presently predict the outcome of these matters, although management believes that the ultimate resolution of these matters will not have a materially adverse effect on the

Company's financial position, results of operations or cash flows.

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Table of Contents**NOTE 13 - SEGMENT INFORMATION**

Segment information is prepared on the same basis that the Company's chief operating decision maker reviews financial information. The Company operates in two industry segments, specialty retail sales and wholesale distribution of fragrances and related products. Retail sales include sales through our Internet site, perfumania.com. Substantially all wholesale sales are to Model and its subsidiaries. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 2. All of the Company's assets relate to and are owned by the Company's retail segment and the Company does not allocate operating and other expenses to its segments. Accordingly, a reconciliation of segment assets to total assets is not presented. During fiscal years 2007, 2006 and 2005, there were no intersegment revenues. Financial information for these segments is summarized in the following table:

| | FISCAL YEAR | | |
|----------------------|----------------|----------------|----------------|
| | 2007 | 2006 | 2005 |
| Net sales: | | | |
| Retail | \$ 244,019,763 | \$ 229,783,211 | \$ 215,841,101 |
| Wholesale | 57,814,867 | 13,825,887 | 17,852,980 |
| | \$ 301,834,630 | \$ 243,609,098 | \$ 233,694,081 |
| Gross profit: | | | |
| Retail | \$ 108,614,493 | \$ 102,975,498 | \$ 95,353,919 |
| Wholesale | 3,250,669 | 954,123 | 1,147,240 |
| | \$ 111,865,162 | \$ 103,929,621 | \$ 96,501,159 |

See Note 6 for disclosure of sales to significant customers.

NOTE 14 - QUARTERLY FINANCIAL DATA (UNAUDITED)

Unaudited summarized financial results for fiscal years 2007 and 2006 follows (in thousands, except for per share data) and have been restated to reflect the adjustments discussed in Note 3 to the consolidated financial statements. With the exception of the fourth quarter of 2006 which is comprised of fourteen weeks, all quarters listed below are comprised of thirteen weeks:

| 2007 QUARTER | FIRST | SECOND | THIRD | FOURTH |
|---|--------------|---------------|--------------|---------------|
| Net sales | \$ 48,139 | \$ 73,391 | \$ 69,884 | \$ 110,421 |
| Gross profit | 20,323 | 24,996 | 24,329 | 42,217 |
| Net income (loss) as previously reported | (1,979) | (321) | (1,117) | N/A |
| Net income (loss) (as restated, see Note 3) | (2,071) | (413) | (1,307) | 3,797 |
| Net income (loss) per basic share as previously reported | (0.65) | (0.10) | (0.37) | N/A |
| Net income (loss) per basic share (as restated, see Note 3) | (0.68) | (0.13) | (0.43) | 1.24 |
| Net income (loss) per diluted share as previously reported | (0.65) | (0.10) | (0.37) | N/A |
| Net income (loss) per diluted share (as restated, see Note 3) | (0.68) | (0.13) | (0.43) | 1.09 |
| 2006 QUARTER | FIRST | SECOND | THIRD | FOURTH |
| Net sales | \$ 46,069 | \$ 50,050 | \$ 53,904 | \$ 93,586 |
| Gross profit | 19,159 | 22,010 | 21,835 | 40,926 |
| Net income (loss) as previously reported | (1,295) | (596) | (1,338) | 7,751 |
| Net income (loss) (as restated, see Note 3) | (1,313) | (622) | (1,387) | 7,712 |
| Net income (loss) per basic share as previously reported | (0.44) | (0.20) | (0.45) | 2.55 |
| Net income (loss) per basic share (as restated, see Note 3) | (0.44) | (0.21) | (0.46) | 2.53 |
| Net income (loss) per diluted share as previously reported | (0.44) | (0.20) | (0.45) | 2.22 |
| Net income (loss) per diluted share (as restated, see Note 3) | (0.44) | (0.21) | (0.46) | 2.30 |

The Company realizes higher sales, gross profit and net income in the fourth fiscal quarter than the other three fiscal quarters due to increased purchases of fragrances as gift items during the holiday season.

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E COM VENTURES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

| | May 3, 2008 | February 2, 2008 |
|--|-----------------------|-----------------------|
| ASSETS: | | |
| Current assets: | | |
| Cash | \$ 1,279,841 | \$ 1,035,073 |
| Trade receivables, no allowance required | 1,450,620 | 1,057,499 |
| Deferred tax asset: current | 4,040,315 | 2,261,856 |
| Inventories, net | 118,856,716 | 107,479,019 |
| Prepaid expenses and other current assets | 4,486,635 | 2,228,013 |
| Total current assets | 130,114,127 | 114,061,460 |
| Property and equipment, net | 38,475,547 | 36,587,935 |
| Goodwill | 1,904,448 | 1,904,448 |
| Deferred tax asset: non-current | 6,980,518 | 6,980,518 |
| Other assets, net | 291,857 | 300,250 |
| Total assets | \$ 177,766,497 | \$ 159,834,611 |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | |
| Current liabilities: | | |
| Accounts payable-non affiliates | \$ 22,898,921 | \$ 19,609,065 |
| Accounts payable-affiliates | 55,891,254 | 48,650,294 |
| Accrued expenses and other liabilities | 10,974,048 | 10,327,794 |
| Bank line of credit | 42,589,627 | 32,840,872 |
| Subordinated convertible note payable - affiliate | 5,000,000 | 5,000,000 |
| Current portion of obligations under capital leases | 363,655 | 355,376 |
| Total current liabilities | 137,717,505 | 116,783,401 |
| Long-term portion of obligations under capital leases | 7,089,759 | 7,190,268 |
| Total liabilities | 144,807,264 | 123,973,669 |
| Commitments and contingencies (see Note 7) | | |
| Shareholders' equity: | | |
| Preferred stock, \$.10 par value, 1,000,000 shares authorized, none issued | | |
| Common stock, \$.01 par value, 6,250,000 shares authorized; 3,957,290 shares issued in 2008 and 2007 | 39,573 | 39,573 |
| Additional paid-in capital | 79,182,694 | 79,182,694 |
| Accumulated deficit | (37,686,090) | (34,784,381) |
| Treasury stock, at cost, 898,249 shares | (8,576,944) | (8,576,944) |
| Total shareholders' equity | 32,959,233 | 35,860,942 |
| Total liabilities and shareholders' equity | \$ 177,766,497 | \$ 159,834,611 |

See accompanying notes to condensed consolidated financial statements.

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E COM VENTURES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | Thirteen Weeks Ended May 3, 2008 | Thirteen Weeks Ended May 5, 2007 (as restated, see Note 2) |
|---|--|---|
| Net sales to: | | |
| Unrelated customers | \$ 46,710,411 | \$ 42,497,127 |
| Affiliates | 9,819,057 | 5,641,425 |
| | 56,529,468 | 48,138,552 |
| Cost of goods sold to: | | |
| Unrelated customers | 24,843,732 | 22,614,268 |
| Affiliates | 9,178,033 | 5,201,615 |
| | 34,021,765 | 27,815,883 |
| Gross profit | 22,507,703 | 20,322,669 |
| Operating expenses: | | |
| Selling, general and administrative expenses | 24,540,926 | 21,128,301 |
| Depreciation and amortization | 1,775,987 | 1,446,701 |
| Total operating expenses | 26,316,913 | 22,575,002 |
| Loss from operations | (3,809,210) | (2,252,333) |
| Interest expense | | |
| Affiliates | (83,438) | (116,910) |
| Other | (787,520) | (970,375) |
| | (870,958) | (1,087,285) |
| Loss before income taxes | (4,680,168) | (3,339,618) |
| Income tax benefit | 1,778,459 | 1,269,000 |
| Net loss | \$ (2,901,709) | \$ (2,070,618) |
| Net loss per common share: | | |
| Basic | \$ (0.95) | \$ (0.68) |
| Diluted | \$ (0.95) | \$ (0.68) |
| Weighted average number of common shares outstanding: | | |
| Basic | 3,059,041 | 3,058,170 |
| Diluted | 3,059,041 | 3,058,170 |

See accompanying notes to condensed consolidated financial statements.

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E COM VENTURES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Thirteen Weeks Ended May 3, 2008 | Thirteen Weeks Ended May 5, 2007 (as restated, see Note 2) |
|--|--|---|
| Cash flows from operating activities: | | |
| Net loss | \$ (2,901,709) | \$ (2,070,618) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Deferred income taxes | (1,778,459) | (1,269,000) |
| Provision for impairment of assets and store closings | 24,849 | 22,500 |
| Depreciation and amortization | 1,775,987 | 1,446,701 |
| Change in operating assets and liabilities: | | |
| Trade receivables | (393,121) | (309,471) |
| Inventories | (11,377,697) | (17,555,728) |
| Prepaid expenses and other assets | (2,250,398) | (205,793) |
| Accounts payable-non affiliates | 2,345,747 | 9,910,139 |
| Accounts payable-affiliates | 7,240,960 | 3,111,447 |
| Accrued expenses and other liabilities | 925,546 | 648,633 |
| Net cash used in operating activities | (6,388,295) | (6,271,190) |
| Cash flows from investing activities: | | |
| Additions to property and equipment | (3,023,462) | (2,563,336) |
| Net cash used in investing activities | (3,023,462) | (2,563,336) |
| Cash flows from financing activities: | | |
| Net borrowings under bank line of credit | 9,748,755 | 9,447,219 |
| Principal payments under capital lease obligations | (92,230) | (83,035) |
| Proceeds from exercise of stock options | | 35,100 |
| Net cash provided by financing activities | 9,656,525 | 9,399,284 |
| Increase in cash and cash equivalents | 244,768 | 564,758 |
| Cash and cash equivalents at beginning of period | 1,035,073 | 1,282,546 |
| Cash and cash equivalents at end of period | \$ 1,279,841 | \$ 1,847,304 |

See accompanying notes to condensed consolidated financial statements.

Supplemental Information:

| | | |
|---|------------|------------|
| Cash paid during the period for: | | |
| Interest | \$ 863,463 | \$ 943,047 |
| Income taxes | 40,000 | |
| Accounts payable for property and equipment | 664,816 | 297,487 |

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E COM VENTURES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 OPERATIONS AND BASIS OF PRESENTATION

E Com Ventures, Inc., a Florida corporation (ECOMV), performs all of its operations through two wholly-owned subsidiaries, Perfumania, Inc. (Perfumania), a Florida corporation, which is a specialty retailer and wholesaler of fragrances and related products, and perfumania.com, Inc., (perfumania.com), a Florida corporation, which is an Internet retailer of fragrances and other specialty items.

Perfumania is a leading specialty retailer and wholesale distributor of a wide range of brand name and designer fragrances. As of May 3, 2008, Perfumania operated a chain of 313 retail stores specializing in the sale of fragrances and related products at discounted prices up to 75% below the manufacturers' suggested retail prices. Perfumania's wholesale division distributes fragrances and related products primarily to an affiliate. Perfumania.com offers a selection of our more popular products for sale over the Internet and serves as an alternative shopping experience to the Perfumania retail stores.

The condensed consolidated financial statements include the accounts of ECOMV and subsidiaries (collectively, the Company). All intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and note disclosures normally included in annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), have been condensed or omitted pursuant to those rules and regulations. The financial information presented herein, which is not necessarily indicative of results to be expected for the current fiscal year, reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the interim unaudited condensed consolidated financial statements. It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended February 2, 2008.

NOTE 2 RESTATEMENT

Subsequent to the issuance of the Company's 2006 financial statements, management identified errors in the accounting for operating leases and the period of amortization of leasehold improvements.

Under GAAP, rent expense is amortized on a straight-line basis over the term of the lease. In prior periods, the Company had determined that the term of the lease begins on the commencement date of the lease, which generally coincides with the store opening date. Management re-evaluated FASB Technical Bulletin No. 85-3, Accounting for Operating Leases with Scheduled Rent Increases and other guidance provided by the SEC and determined that the lease term for amortization purposes should commence on the date the Company takes physical possession of the leased space to commence construction of leasehold improvements, which is generally two months prior to a store opening date. The Company has restated its previously reported financial statements in connection with its accounting for rent expense. Rent expense is included in selling, general and administrative expenses on the Company's condensed consolidated statements of operations.

Management has also reviewed its leasehold improvements to ensure amortization over the shorter of their economic lives or their lease term. In prior periods, in determining the lease terms, in addition to the initial term, the Company had included one anticipated renewal term even if the lease did not have a stated renewal option. The Company has adjusted its lease terms for purposes of calculating amortization of leasehold improvements to include a renewal term only if that renewal option is specified in the lease agreement and that exiting the lease after the initial lease term would result in economic loss and therefore normally management anticipates exercising the respective renewal option.

The following is a summary of the effects of the restatement to the Company's Condensed Consolidated Financial Statements.

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| | Condensed Consolidated Statements of Operations | | |
|--|--|--------------------|--------------------|
| | As previously reported | Adjustments | As restated |
| Thirteen weeks ended May 5, 2007 | | | |
| Selling, general and administrative expenses | \$ 21,094,745 | \$ 33,556 | \$ 21,128,301 |
| Depreciation and amortization | 1,332,701 | 114,000 | 1,446,701 |
| Total operating expenses | 22,427,446 | 147,556 | 22,575,002 |
| Loss from operations | (2,104,777) | (147,556) | (2,252,333) |
| Loss before income taxes | (3,192,062) | (147,556) | (3,339,618) |
| Income tax benefit | 1,213,000 | 56,000 | 1,269,000 |
| Net loss | (1,979,062) | (91,556) | (2,070,618) |
| Basic net loss per common share | \$ (0.65) | \$ (0.03) | \$ (0.68) |
| Diluted net loss per common share | \$ (0.65) | \$ (0.03) | \$ (0.68) |

| | Condensed Consolidated Statements of Cash Flows | | |
|--|--|--------------------|--------------------|
| | As previously reported | Adjustments | As restated |
| Net loss | \$ (1,979,062) | \$ (91,556) | \$ (2,070,618) |
| Deferred income taxes | 1,213,000 | 56,000 | 1,269,000 |
| Depreciation and amortization | 1,332,701 | 114,000 | 1,446,701 |
| Accrued expenses and other liabilities | 615,077 | 33,556 | 648,633 |

NOTE 3 ACCOUNTING FOR SHARE-BASED PAYMENT

The Company has two stock option plans which provide for equity-based awards to its employees and directors (collectively, the Plans). Under the Plans, the Company has reserved approximately 1,000,000 shares of common stock, of which approximately 590,000 options have been granted and approximately 148,000 options are outstanding. All stock options have an exercise price that is equal to the fair market value of the Company's stock on the date the options were granted. The term of the stock option awards is ten years from the date of grant. All granted and outstanding options were fully vested during the quarter ended May 3, 2008.

The following is a summary of the stock option activity during the thirteen weeks ended May 3, 2008:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value |
|--|-------------------------|--|--|----------------------------------|
| Outstanding and exercisable as of February 2, 2008 | 147,696 | \$ 12.80 | 6.17 | \$ 1,732,000 |
| Granted | | | | |
| Exercised | | | | |
| Forfeited | | | | |
| Outstanding and exercisable as of May 5, 2008 | 147,696 | \$ 12.80 | 5.92 | \$ 1,132,000 |

The aggregate intrinsic value in the table above is the amount before applicable income taxes which would have been received by the optionees based on the Company's closing stock price as of the last business day of the respective period had all options been exercised on that date.

We compute share based compensation pursuant to Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment (SFAS No. 123 (R)). During the thirteen weeks ended May 3, 2008 and May 5, 2007, the Company did not recognize any share based compensation expense in the condensed consolidated financial statements since no stock options were granted nor were there any modifications of outstanding stock options during such periods.

Table of Contents**NOTE 4 BANK LINE OF CREDIT AND NOTES PAYABLE**

The bank line of credit and notes payable, all of which is classified as current, consist of the following:

| | May 3, 2008 | February 2, 2008 |
|---|---------------|------------------|
| Bank line of credit interest payable monthly, secured by a pledge of substantially all of Perfumania's assets | \$ 42,589,627 | \$ 32,840,872 |
| Subordinated convertible note payable-affiliate | \$ 5,000,000 | \$ 5,000,000 |

Perfumania's senior secured credit facility provides for borrowings of up to \$60 million, depending on the Company's levels of eligible inventories. Advances under the line of credit are based on a formula of eligible inventories and bear interest at a floating rate ranging from (a) prime to prime plus 1.25% or (b) LIBOR plus 2.5% to 3.75% depending on a financial ratio test. As of May 3, 2008, \$42.6 million was outstanding under the line of credit and \$12.0 million was available to support normal working capital requirements and other general corporate purposes based upon our eligible borrowing base, net of the restrictions concerning minimum undrawn availability discussed below. Advances are secured by a first lien on all assets of Perfumania. The credit facility contains limitations on additional borrowings, capital expenditures and other items, and contains various covenants including a fixed charge coverage ratio, a leverage ratio and capital expenditure limits as defined. The credit facility also prohibits the Company from paying cash dividends. In June 2007, the minimum undrawn availability as defined was amended so that Perfumania is required to maintain at all times, a minimum undrawn availability of not less than \$5,000,000, and shall maintain a monthly average undrawn availability, as defined, of not less than \$7,500,000. In May 2008, the fixed charge covenant and the covenant concerning the limitation on capital expenditures were amended with an effective date of February 1, 2008. Perfumania was in compliance with all covenant requirements as of May 3, 2008 and believes it will remain in compliance through the extension period discussed below.

The credit facility expired on May 12, 2008. In May 2008, the Company obtained a ninety day extension of the credit facility to August 11, 2008. In May 2008, the Company received a commitment from the lender to extend the credit facility through May 2009 which it did not execute. As discussed in Note 8, the Merger with Model Reorg, Inc. (Model) is subject to a number of terms, one of which includes the requirement that the Company and Model obtain a commitment for asset-based loans and term debt facilities in amounts and on terms that are substantially similar to those contemplated by a previous commitment that was obtained in August 2007. The August 2007 commitment provided for replacement senior credit facilities for us and Model in an aggregate amount of up to \$280 million, to be established upon the closing of the Merger. That commitment expired by its terms in November 2007. A comparable commitment on substantially similar terms and amounts was obtained from the same lender on May 16, 2008 which is available through August 16, 2008.

Failure of the Merger with Model to close prior to the expiration of the credit facility on August 11, 2008 will result in the Company having to seek an additional extension of its facility, or to obtain an alternative source of financing. Management of the Company believes that alternative financing sources on terms acceptable would be available, however there is no guarantee that such will occur.

In March 2004, Glenn and Stephen Nussdorf (the Nussdorfs) provided a \$5,000,000 subordinated secured demand loan to Perfumania. The demand loan required quarterly interest payments at the prime rate plus 1%. There were no prepayment penalties and the loan was subordinate to all bank related indebtedness. On December 9, 2004, the Company issued a Subordinated Convertible Note (the Convertible Note) in exchange for the \$5,000,000 subordinated secured demand loan. The Convertible Note bears interest at the prime rate plus 1%, requires quarterly interest payments and is secured by a security interest in the Company's assets pursuant to a Security Agreement, by and among the Company and the Nussdorfs. There are no prepayment penalties and the Convertible Note is subordinate to all bank related indebtedness. The Convertible Note was originally payable in January 2007 however it was modified in January 2006 to extend the due date to January 2009. The Note allows the Nussdorfs to convert the Convertible Note into shares of the Company's common stock at a conversion price of \$11.25, which equaled the closing market price of the Company's common stock on the date of the exchange. See Note 8 for discussion of transactions between the Company and Model.

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NOTE 5 ACCOUNTING FOR INCOME TAXES

The Company adopted the provisions of FIN 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, (FIN 48) effective February 4, 2007. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in an income tax return. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures.

As a result of the implementation of FIN 48, the Company did not recognize a liability for unrecognized tax benefits or reverse any accruals for uncertain tax positions previously recorded, and accordingly, was not required to record any cumulative effect adjustment to beginning of year retained earnings. As of both the date of adoption and May 3, 2008, there was no liability for income tax associated with uncertain tax positions.

The Company accrues interest related to unrecognized tax benefits as well as any related penalties in operating expenses in its condensed consolidated statements of operations, which is consistent with the recognition of these items in prior reporting periods. As of the date of adoption, the Company was not required to have an accrual for the payment of interest and penalties. No accrual for interest and penalties related to uncertain tax positions was required as of May 3, 2008.

The Company operates stores throughout the United States and Puerto Rico, and as a result, files income tax returns in the United States federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities. We are no longer subject to income tax examinations by the Internal Revenue Service for fiscal years prior to 2003.

State and foreign income tax returns are generally subject to examination for a period of three to five years after filing of the respective return. The state impact of any federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states. The Company is not currently under examination in any state or foreign jurisdictions.

The Company does not anticipate any material adjustments relating to unrecognized tax benefits within the next twelve months, however the ultimate outcome of tax matters is uncertain and unforeseen results can occur.

NOTE 6 BASIC AND DILUTED LOSS PER COMMON SHARE

Basic loss per common share has been computed by dividing net loss by the weighted average number of common shares outstanding during the period. For all periods presented in the accompanying condensed consolidated statements of operations, all incremental shares attributed to outstanding stock options and convertible notes were not included because the results would be anti-dilutive.

NOTE 7 CONTINGENCIES

The Company is involved in various legal proceedings in the ordinary course of business. Management cannot presently predict the outcome of these matters, although management believes that the ultimate resolution of these matters will not have a materially adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Table of Contents**NOTE 8 RELATED PARTY TRANSACTIONS**

Glenn and Stephen Nussdorf (the Nussdorfs) own an aggregate 1,113,144 shares or approximately 36% of the total number of shares of the Company's common stock as of May 3, 2008, excluding shares issuable upon conversion of the Convertible Note discussed in Note 4. Stephen Nussdorf has served as the Company's Chairman of the Board since February 2004.

The Nussdorfs are officers and principals of Model and its affiliate, Quality King Distributors, Inc. (Quality King) and their subsidiaries, including Quality King Fragrances, Inc. Model is a diversified wholesale and retail fragrance company and Quality King distributes pharmaceuticals and health and beauty care products. The Company's President and Chief Executive Officer, Michael W. Katz is an executive of Model and Quality King and the Company's principal shareholders, Stephen Nussdorf, the Chairman of the Company's Board of Directors and Glenn Nussdorf, his brother, are shareholders and executives of Model and Quality King.

Sales To and Purchases From Affiliated Companies

The Company sold approximately \$9.8 million and \$5.6 million of wholesale merchandise to Model and its subsidiaries in the thirteen weeks ended May 3, 2008 and May 5, 2007, respectively. See further discussion at Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-Q regarding significant increases in wholesale sales volume. For all periods presented, substantially all of the Company's wholesale sales were to Model and its subsidiaries. The wholesale sales to Model and its subsidiaries result from the Company's supplier relationships and its ability to obtain certain merchandise at better prices and in greater quantities than Model and its subsidiaries are able to achieve. These wholesale sales are included in net sales-affiliates in the accompanying condensed consolidated statements of operations. There were approximately \$0.2 million of accounts receivable due from Model and its subsidiaries as of May 3, 2008.

Glenn Nussdorf (Mr. Nussdorf) beneficially owns approximately 12% of the outstanding common stock of Parlux Fragrances, Inc. (Parlux), a manufacturer and distributor of prestige fragrances and beauty products. In February 2007, Mr. Nussdorf reached an agreement with Parlux which called for equal representation in Parlux's Board of Directors by the then current independent directors and Mr. Nussdorf's nominees. Accordingly, Mr. Nussdorf's three nominees were appointed to the Parlux Board, and one of these nominees currently serves as Parlux's Chief Executive Officer.

Purchases of merchandise from Parlux and Model and its subsidiaries aggregated approximately \$10.5 million and \$7.5 million for the thirteen weeks ended May 3, 2008 and May 5, 2007, representing approximately 23.0% and 17.1% of the Company's total inventory purchases, respectively. The amounts due to Parlux at May 3, 2008 and February 2, 2008 were approximately \$15.4 million and \$12.5 million, respectively. The amounts due to Model and its subsidiaries at May 3, 2008 and February 2, 2008 were approximately \$40.5 million and \$36.1 million, respectively. These amounts are non-interest bearing and are included in accounts payable-affiliates in the accompanying condensed consolidated balance sheets. Purchases from related parties are generally payable in 90 days, however, due to the seasonality of the Company's business, these terms are generally extended. Related party accounts are historically brought closer to terms at the end of the holiday season, however, we are dependent upon these extended terms for much of our liquidity during the year.

Merger Agreement with Model and Other Arrangements

As reported in the Company's Form 8-K filed with the SEC on December 21, 2007, the Company entered into an Agreement and Plan of Merger (the Merger Agreement) with Model, a New York corporation controlled by the family of Glenn and Stephen Nussdorf, principal shareholders of the Company, on December 21, 2007. Model is a diversified wholesale and retail fragrance company. Stephen Nussdorf is the Chairman of our Board of Directors, and Michael W. Katz, our President and Chief Executive Officer, is an executive of Model. Pursuant to the terms of the Merger Agreement, Model will be merged into a newly formed wholly-owned subsidiary of the Company in exchange for the issuance of 5,900,000 shares of the Company's common stock and warrants to acquire an additional 1,500,000 shares of the Company's common stock at an exercise price of \$23.94. The warrants will have a 10-year term, will not be exercisable for the first three years and will not be transferable, with limited exceptions.

The Merger Agreement was reached after extensive negotiations between Model and a special committee comprised of the independent Board members of the Company, which retained independent counsel and financial advisors. The special committee

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received an opinion from Financo, Inc. that, as of the date of the Merger Agreement and subject to various assumptions and qualifications set forth therein, the consideration to be paid by the Company in the merger is fair to the shareholders of the Company (other than shareholders of the Company who own or whose affiliates own securities of Model) from a financial point of view.

The Merger Agreement also required Model to refinance debt owed by Model to its affiliate, Quality King. The refinancing is to be through a \$50 million three-year term loan from trusts for the benefit of Glenn and Stephen Nussdorf and their families and, if needed, a transfer of inventory from Model to Quality King to pay any remaining balance. The new loan will be subordinated to the new secured credit facility described below.

The consummation of the contemplated Merger is subject to certain conditions, including approval by the holders of a majority of the votes cast at a meeting of shareholders of the Company and the availability of a new \$280 million secured credit facility to replace the Company's and Model's existing third party credit facilities for which a commitment was obtained in August 2007, but which expired by its terms in November 2007. A comparable commitment with substantially similar terms was obtained from the same lender in May 2008 which is available through August 16, 2008.

Included in selling, general and administrative expenses on the Company's condensed consolidated statement of operations for the thirteen weeks ended May 3, 2008 are \$0.2 million of expenses related to the Merger. These expenses consist primarily of financial advisory, legal and due diligence fees.

Following the contemplated Merger, the Nussdorfs, who currently own 36% of the Company's outstanding common stock, would own approximately 51% of the Company's outstanding common stock. Giving effect to the conversion of our \$5 million subordinated convertible note currently held by them and the exercise of the warrants to be issued to them in the transaction, but not assuming the exercise of any outstanding options held by the Company's officers and directors, they would own approximately 58% of the Company's common stock.

In addition, the Company's Board approved changing the Company's name to Perfumania Holdings, Inc., subject to shareholder approval.

On March 12, 2008, the Company filed a preliminary proxy statement with the SEC discussing the Merger Agreement and the related required shareholder approvals, including the issuance of the additional shares of the Company's common stock pursuant to the Merger Agreement and the related amendments to the Company's articles of incorporation.

On August 2, 2007, the Company entered into an Information Technology Services Agreement (the "Services Agreement") with Model and its subsidiaries, whereby among other services, the Company will manage and monitor the IT systems of Model in exchange for a monthly service fee of \$25,000. The Services Agreement terminates 30 days after the effective date of the merger discussed above, or if such merger offer is not consummated on or before December 31, 2008, either party may terminate 30 days after providing written notice of termination. During the thirteen weeks ended May 3, 2008, the Company recorded income of \$75,000 related to this Services Agreement which is included as a reduction to selling, general and administrative expenses on the condensed consolidated statement of operations for the thirteen weeks ended May 3, 2008.

NOTE 9 SEGMENT INFORMATION

Segment information is prepared on the same basis that the Company's chief operating decision maker reviews financial information. The Company operates in two industry segments, specialty retail sales and wholesale distribution of fragrances and related products. Retail sales include sales through our internet site, perfumania.com. Substantially all wholesale sales are to Model and its subsidiaries. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 2 of the Notes to our Consolidated Financial Statements included in our 2007 Annual Report on Form 10-K. All of the Company's assets relate to and are owned by the Company's retail segment and the Company does not allocate operating and other expenses to its segments. Accordingly, a reconciliation of segment assets to total assets is not presented. During the thirteen weeks ended May 3, 2008 and May 5, 2007, there were no intersegment revenues. Financial information for these segments is summarized in the following table.

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| | Thirteen Weeks Ended May 3, 2008 | Thirteen Weeks Ended May 5, 2007 |
|---------------|--|--|
| Net sales: | | |
| Retail | \$ 46,710,411 | \$ 42,488,370 |
| Wholesale | 9,819,057 | 5,650,182 |
| | \$ 56,529,468 | \$ 48,138,552 |
| Gross profit: | | |
| Retail | \$ 21,866,679 | \$ 19,881,608 |
| Wholesale | 641,024 | 441,061 |
| | \$ 22,507,703 | \$ 20,322,669 |

See Note 8 for disclosure of sales to significant customers.

NOTE 10 RECENT ACCOUNTING PRONOUNCEMENTS

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities* an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 requires enhanced disclosures regarding derivatives and hedging activities, including: (a) the manner in which an entity uses derivative instruments; (b) the manner in which derivative instruments and related hedged items are accounted for under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ; and (c) the effect of derivative instruments and related hedged items on an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. As SFAS 161 relates specifically to disclosures, it will have no impact on the Company's results of operations, financial position or cash flows.

In December 2007, the FASB issued SFAS 141(R), *Business Combinations* (SFAS 141(R)). SFAS 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, the goodwill acquired, and any noncontrolling interest in the acquiree. This statement also establishes disclosure requirements to enable the evaluation of the nature and financial effect of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company is in the process of evaluating the effect that the adoption of SFAS 141(R) will have on its results of operations, financial position, and cash flows.

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment of ARB No. 51. (SFAS 160). SFAS 160 amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. The Company is in the process of evaluating the effect that the adoption of SFAS 160 will have on its results of operations, financial position, and cash flows.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities* Including an amendment of FASB Statement 115. (SFAS 159). SFAS 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective for fiscal 2008. The adoption of SFAS 159 did not have any effect on the Company's results of operations, financial position or cash flows.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements and, accordingly, does not require any new fair value measurements. SFAS 157 is effective for the first interim period beginning in fiscal 2008 for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis in financial statements. In November 2007, the FASB provided a one year deferral for the implementation of SFAS 157 for other nonfinancial assets and liabilities. The adoption of SFAS 157 did not have a material effect on the Company's results of operations, financial position or cash flows.

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Independent Auditors Report

Model Reorg, Inc. and Subsidiaries

Bellport, New York

We have audited the accompanying consolidated balance sheets of Model Reorg, Inc. and Subsidiaries as of October 31, 2007 and 2006 and the related consolidated statements of income, stockholders' equity and cash flows for the years ended October 31, 2007, 2006 and 2005. 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Model Reorg, Inc. and Subsidiaries as of October 31, 2007 and 2006 and the results of its operations and its cash flows for the years ended October 31, 2007, 2006 and 2005 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company has restated its 2006 and 2005 consolidated financial statements.

/s/ BDO Seidman, LLP

BDO Seidman, LLP

New York, New York

February 12, 2008

Table of Contents**Model Reorg, Inc. and Subsidiaries****Consolidated Balance Sheets****(Dollars In Thousands)**

| <i>October 31,</i> | 2007 | 2006 (Restated) |
|---|-------------------|--------------------|
| Assets | | |
| Current | | |
| Cash | \$ 2,988 | \$ 2,737 |
| Accounts receivable - net of allowances of \$269 and \$275 | 56,960 | 47,728 |
| Receivables from an affiliate | 25,484 | 16,727 |
| Inventories, net | 218,206 | 209,934 |
| Advances to suppliers for future purchases | 1,132 | 2,133 |
| Prepays and other | 7,554 | 7,351 |
| Total current assets | 312,324 | 286,610 |
| Property and equipment, at cost, less accumulated depreciation | 2,496 | 2,594 |
| Goodwill | 20,434 | 9,392 |
| Other assets, net | 9,734 | 8,248 |
| | \$ 344,988 | \$ 306,844 |
| Liabilities and Stockholders Equity | | |
| Current | | |
| Accounts payable - non affiliates | \$ 30,882 | \$ 33,303 |
| Accounts payable - affiliates | 2,152 | |
| Accrued expenses | 9,359 | 7,071 |
| Accrued income taxes | | 2,169 |
| Other current liabilities | 2,548 | 1,903 |
| Current maturities of long-term debt | 209 | 3,242 |
| Total current liabilities | 45,150 | 47,688 |
| Long-term debt and other | 138,914 | 124,274 |
| Notes payable - former stockholder | | 158 |
| Payable to affiliate | 76,313 | 73,089 |
| Total liabilities | 260,377 | 245,209 |
| Commitments and Contingencies (Note 10) | | |
| Stockholders equity | | |
| Common stock, no par value - 200 shares authorized - 111 and 100 shares issued at October 31, 2007 and 2006, respectively | 1 | 1 |
| Additional paid-in capital | 13,905 | 2,179 |
| Retained earnings | 72,180 | 60,930 |
| Treasury stock - 14 shares at cost | (1,475) | (1,475) |
| Total stockholders equity | 84,611 | 61,635 |
| | \$ 344,988 | \$ 306,844 |

See accompanying independent auditors report and notes to consolidated financial statements

Table of Contents**Model Reorg, Inc. and Subsidiaries****Consolidated Statements of Income****(Dollars In Thousands)**

| <i>Year ended October 31,</i> | 2007 | 2006 (Restated) | 2005 (Restated) |
|---|-------------------|---------------------------|---------------------------|
| Net revenues, unaffiliated | \$ 302,530 | \$ 306,089 | \$ 278,619 |
| Net revenues, affiliated | 25,182 | 32,272 | 38,288 |
| Total net revenues | 327,712 | 338,361 | 316,907 |
| Cost of goods sold, unaffiliated | 212,111 | 216,489 | 201,674 |
| Cost of goods sold, affiliated | 25,092 | 28,835 | 33,773 |
| Gross Profit | 90,509 | 93,037 | 81,460 |
| Selling, warehouse, delivery and administrative expenses | 61,524 | 59,269 | 57,158 |
| (Recovery) provision on vendor advances | (2,367) | 2,367 | |
| Income from operations | 31,352 | 31,401 | 24,302 |
| Interest expense | 12,749 | 14,506 | 11,179 |
| Income before income taxes | 18,603 | 16,895 | 13,123 |
| Income taxes | 7,353 | 6,854 | 5,121 |
| Net income | \$ 11,250 | \$ 10,041 | \$ 8,002 |

See accompanying independent auditors report and notes to consolidated financial statements

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Model Reorg, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity

(Dollars In Thousands)

| | Common Stock | Additional Paid-in Capital | Retained Earnings (Restated) | Treasury Stock | Total Stockholders Equity (Restated) |
|----------------------------------|--------------|----------------------------------|------------------------------------|-------------------|---|
| Balance, November 1, 2004 | \$ 1 | \$ 2,179 | \$ 42,887 | \$ (1,475) | \$ 43,592 |
| Net income | | | 8,002 | | 8,002 |
| Balance, October 31, 2005 | 1 | 2,179 | 50,889 | (1,475) | 51,594 |
| Net income | | | 10,041 | | 10,041 |
| Balance, October 31, 2006 | 1 | 2,179 | 60,930 | (1,475) | 61,635 |
| Net income | | | 11,250 | | 11,250 |
| Acquisition of Jacavi | | 10,800 | | | 10,800 |
| Stockholder contribution | | 926 | | | 926 |
| Balance, October 31, 2007 | \$ 1 | \$ 13,905 | \$ 72,180 | \$ (1,475) | \$ 84,611 |

See accompanying independent auditors report and notes to consolidated financial statements

Table of Contents**Model Reorg, Inc. and Subsidiaries****Consolidated Statements of Cash Flows****(Dollars In Thousands)**

| Year Ended October 31, | 2007 | 2006 (Restated) | 2005 (Restated) |
|---|-----------------|--------------------|--------------------|
| Cash flows from operating activities: | | | |
| Net income | \$ 11,250 | \$ 10,041 | \$ 8,002 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | | |
| Deferred tax expense (benefit) | 2,615 | 20 | (75) |
| (Recovery) provision on vendor advances | (2,367) | 2,367 | |
| Depreciation and amortization | 1,411 | 1,721 | 2,469 |
| Provision for losses on accounts receivable | 40 | 77 | 177 |
| Changes in assets and liabilities: | | | |
| (Increase) decrease in: | | | |
| Accounts receivable | (9,272) | (1,781) | 11,245 |
| Receivables from affiliate | (8,757) | 3,887 | (9,211) |
| Inventories | (8,272) | 10,557 | (7,118) |
| Advances to suppliers for future purchases | 3,368 | 1,035 | 670 |
| Prepays and other | (2,818) | (970) | 568 |
| Increase (decrease) in: | | | |
| Accounts payable, non affiliates | (2,421) | 9,584 | (31,637) |
| Accounts payable, affiliates | 2,152 | | |
| Accrued expenses and other liabilities | 764 | 2,696 | 3,051 |
| Total adjustments | (23,557) | 29,193 | (29,861) |
| Net cash (used in) provided by operating activities | (12,307) | 39,234 | (21,859) |
| Cash flows from investing activities: | | | |
| Purchase of property and equipment | (505) | (2,023) | (484) |
| Acquisition of Northern Group, Inc. | | (242) | (627) |
| Acquisition of Jacavi, LLC | (242) | | |
| Other investing activities | (1,368) | (2,345) | (1,312) |
| Net cash used in investing activities | (2,115) | (4,610) | (2,423) |
| Cash flows from financing activities: | | | |
| Increase (decrease) in revolving credit borrowings | 15,459 | (21,200) | 31,023 |
| Proceeds from (repayment) of affiliated note payable | 3,224 | (10,643) | (727) |
| Payment of long-term debt and other | (3,852) | (2,284) | (3,838) |
| Payment of notes payable - former stockholder | (158) | (281) | (432) |
| Net cash provided by (used in) financing activities | 14,673 | (34,408) | 26,026 |
| Net increase in cash | 251 | 216 | 1,744 |
| Cash, beginning of year | 2,737 | 2,521 | 777 |
| Cash, end of year | \$ 2,988 | \$ 2,737 | \$ 2,521 |

See accompanying independent auditors report and notes to consolidated financial statements

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Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)****1. Summary of Accounting Policies** *(a) Basis of Presentation*

The consolidated financial statements of Model Reorg, Inc. include the following wholly owned subsidiaries: Five Star Fragrance Co. Inc., Quality King Fragrance, Inc., Scents of Worth, Inc. and Jacavi, LLC (collectively the Company). The Company is an affiliate of Quality King Distributors, Inc. (QKD) and E Com Ventures, Inc. (E Com) through common ownership.

Effective October 2004, Model Reorg acquired all of the stock of Northern Group, Inc., (Northern), a fragrance distributor, for a total purchase price of \$11,998 in a business combination accounted for as a purchase. The results of operations of Northern are included in the accompanying consolidated financial statements as of the date of acquisition. Based on the fair values of the assets acquired and liabilities assumed, the Company recorded goodwill of \$9,392.

On October 5, 2007, the Company acquired all the stock of Jacavi, LLC (Jacavi) a fragrance distributor, in exchange for shares of Model Reorg common stock which was valued at \$10,800. The acquisition was accounted for as a purchase and the results of operations of Jacavi are included in the accompanying consolidated financial statements since the date of acquisition. In connection with the acquisition, the Company obtained a valuation of Jacavi from an independent company. Based on the fair value of the assets acquired and liabilities assumed, and the purchase consideration associated with the acquisition, the Company recorded goodwill of \$11,042, including \$242 of acquisition costs.

Based on the Company's purchase price allocation, the cost of the acquisition was allocated to the fair value of the net assets acquired as follows:

| | |
|--|---------------|
| Accounts Receivable and other current assets | \$ 1,566 |
| Inventories | 4,990 |
| Goodwill | 11,042 |
| Accounts Payable and other liabilities | (1,616) |
| Payable to Model | (4,940) |
| Total cost of acquisition | \$ 11,042 |

All significant intercompany balances and transactions have been eliminated.

Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)***(b) Restatements of Previously Issued Consolidated Financial Statements*

During 2007, the Company identified incorrectly reported amounts related to inventory reserves, deferred revenue (included in accrued expenses) and federal and state income taxes. As of November 1, 2004, retained earnings was restated by \$5,071 relating to amounts that were previously reported. The following is a summary of the effects of the restatements on the 2006 and 2005 financial statements.

| | 2006 | 2006 | 2005 | 2005 |
|-------------------|--------------------|-----------------|--------------------|-----------------|
| | As Reported | Restated | As Reported | Restated |
| Net Income | \$ 9,744 | \$ 10,041 | \$ 7,626 | \$ 8,002 |
| Total Assets | \$ 304,341 | \$ 306,844 | \$ 318,719 | \$ 318,931 |
| Total Liabilities | \$ 248,450 | \$ 245,209 | \$ 272,572 | \$ 267,337 |
| Retained Earnings | \$ 55,184 | \$ 60,930 | \$ 45,440 | \$ 50,889 |

(c) Reclassifications

Certain fiscal 2006 and 2005 amounts in the accompanying consolidated financial statements have been reclassified to conform to the fiscal 2007 presentation.

(d) Organization and Business

The Company is primarily a promotional wholesale distributor of fragrances. Customers include traditional wholesalers, chain stores, mass merchandisers and retail wholesale clubs throughout the United States. In addition, the Company has an arrangement with approximately 3,000 store locations with major retailers and sells designer fragrances on consignment. The Company also manufactures fragrances, which it owns or licenses from others.

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars In Thousands)

(e) 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 that 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. Actual results could differ from those estimates and assumptions.

In fiscal 2006, the Company recorded an estimated provision for losses of \$2,367 on vendor advances. The advances that were reserved related to the entities involved in the Jacavi acquisition. When the acquisition of Jacavi was certain in 2007, the estimated provision was reversed.

(f) Inventories

Inventories are valued at the lower of cost or market and are costed using the weighted average method, which approximates first-in, first-out (FIFO). Inventory reserves are based on the net realizable value of the inventory and are determined based on historical sales, aging of inventories and estimated marketability.

(g) Property and Equipment, and Depreciation

Depreciation is computed by the straight-line and accelerated methods over the estimated useful lives of the assets ranging primarily from three to seven years.

(h) Leased Property Under Capital Leases

Property under capital leases is amortized over the lives of the respective leases or useful lives of the assets, whichever is shorter, ranging from five to ten years.

(i) Goodwill

Goodwill and certain indefinite-lived intangibles are not amortized, and are tested for impairment, at least annually. There is a two-step process for impairment testing of goodwill. The first step of this test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. The second step (if necessary) measures the amount of the impairment. Based on the management's impairment review, there was no impairment identified in the recorded goodwill.

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars In Thousands)

(j) Income Taxes

Model Reorg. and subsidiaries are C corporations and provisions have been made for income tax expense at statutory rates. The Company follows the liability method of accounting for income taxes. The primary objectives of accounting for income taxes are to recognize the amount of tax payable for the current year and recognize the amount of deferred tax asset or liability for the future tax consequences of events that have been reflected in the Company's financial statements or tax returns.

(k) Revenue Recognition

Sales are recognized when title passes which occurs either upon shipment of products, delivery of products, or sale to the ultimate customers from consignment inventories. Allowances for estimated returns and pricing adjustments are provided when sales are recognized and are recorded as a reduction of sales. Allowances provided for advertising, marketing and tradeshows are recorded as selling expenses since they are costs for services received from the customer which are separable from the customer's purchase of the Company products. Accruals and allowances are estimated based on available information including third party data.

(l) Concentrations of Credit Risk

The Company is potentially subject to a concentration of credit risk with respect to its trade receivables, the majority of which are due from retailers and wholesale distributors. Credit risks also relate to the seasonal nature of the business. The Company's sales are concentrated in November and December for the holiday season. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. The Company maintains allowances to cover potential or anticipated losses for uncollectible accounts. The Company maintains credit insurance on certain receivables, which minimizes the financial impact of uncollectible accounts.

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars In Thousands)

(m) Long-Lived Assets

The Company periodically reviews long-lived assets for impairment whenever changes in the circumstances indicate that the carrying amount of the assets may not be fully recoverable. The Company considers cash flow, management's strategic plans, significant decreases in the market value of the asset and other available information in assessing whether the carrying value of the assets can be recovered. No impairment losses have been recognized through October 31, 2007.

(n) New Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized under SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on various related matters such as derecognition, interest and penalties, and disclosure. The effective date of FIN 48 for non-public enterprises is for annual periods beginning after December 15, 2007. The Company has begun evaluating the financial impact of applying the provisions of FIN 48 to all tax positions and it does not believe there will be a material financial impact upon the initial adoption of FIN 48.

2. Inventories

Inventories, which are primarily comprised of finished products, are shown net of reserves for obsolescence and market write downs. Reserves at October 31, 2007 and 2006 were \$2,968 and \$4,092, respectively.

Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)****3. Related Party Transactions**

(a) The Company receives services from QKD pursuant to a service agreement. The agreement with QKD provides for the allocation of expenses, which are calculated based on various assumptions and methods. The methods employed utilize various allocation bases including the number of transactions processed, estimated delivery miles, warehouse square footage, payroll dollars and sales and inventory ratios. The following table summarizes the expenses, which were allocated to the Company.

Year ended October 31,

| | 2007 | | 2006 | | 2005 | |
|----------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| | Total | Allocated | Total | Allocated | Total | Allocated |
| Warehouse and delivery | \$ 19,953 | \$ 1,206 | \$ 17,074 | \$ 1,888 | \$ 17,280 | \$ 2,241 |
| Selling and administrative | 41,571 | 2,884 | 42,195 | 3,504 | 39,878 | 2,513 |
| Interest expense | 12,749 | 8,031 | 14,506 | 7,800 | 11,179 | 5,523 |
| | \$ 74,273 | \$ 12,121 | \$ 73,775 | \$ 13,192 | \$ 68,337 | \$ 10,277 |

Allocated interest expense represents interest expense on the Company's revolving credit borrowings (see Note 7) and is allocated at the same effective rate as in the QKD credit agreement.

The Company believes that the allocated expenses are reasonable and approximate those expenses that would have been incurred had the Company not operated under a service agreement.

(b) On August 2, 2007 the Company entered into a service agreement with E Com whereby E Com provides IT Management Support services for all of the Company's computer systems at a rate of \$25 per month, plus out of pocket expenses. This agreement will terminate at consummation of the Company's merger with E Com or January 29, 2009, if the merger has not been finalized.

Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)**

(c) The Company had sales and purchase transactions with E Com as follows: for the years ended October 31, 2007, 2006 and 2005 the sales were \$25,182, \$32,272 and \$38,288, respectively, and purchases were \$49,188, \$17,276 and \$17,468, respectively. The Company had a receivable balance from this affiliate of \$25,484 and \$16,727 at October 31, 2007 and 2006, respectively. The Company had a payable balance to this affiliate of \$2,152 at October 31, 2007.

(d) In December 2007, the Company began subletting new office and warehouse space from QKD (see Note 10).

(e) During fiscal 2007, additional paid in capital increased \$926 as a result of certain tax benefits relating to the allocation of related party expenses.

(f) Included in other current liabilities is deferred compensation due to an officer. The Company's liability is calculated by a formula and totals \$1.5 million and \$1.2 million for the years ended October 31, 2007 and 2006, respectively.

4. Property and Equipment

Major classes of property and equipment are stated at cost and consist of the following:

| <i>October 31,</i> | 2007 | 2006 |
|-------------------------------|-----------------|----------|
| Buildings and improvements | \$ 433 | \$ 432 |
| Machinery and equipment | 4,858 | 6,157 |
| Construction in progress | 1,711 | 1,728 |
| Furniture and fixtures | 3,470 | 3,298 |
| | 10,472 | 11,615 |
| Less accumulated depreciation | (7,976) | (9,021) |
| | \$ 2,496 | \$ 2,594 |

5. Other Assets

Included in other assets is the net book value of trademarks and licenses of Five Star Fragrance, Inc. Net book values of these intangibles were \$5,574 and \$6,384 at October 31, 2007 and 2006, respectively. Estimated amortization expense for each of the five succeeding fiscal years is \$809 for years 2008 and 2009, \$452 for year 2010, and \$381 for years 2011 and 2012. Based on management's impairment review, there was no impairment identified related to these assets.

Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)****6. Payable to affiliate**

The Company has a long-term note payable to QKD. This note supplements the Company's borrowings under the Credit Facility, see note 7(a). The Company is charged interest by QKD based on the monthly blended borrowing rates, which are based on the LIBOR and Prime rates. Interest rates on the note for the years ended 2007, 2006, and 2005 averaged 7.6%, 7.4%, and 5.8%, respectively. Interest expense charged to operations relating to the note payable was \$4,571, \$6,474 and \$5,032 for the years ending October 31 2007, 2006 and 2005, respectively. The note is classified as long-term as QKD will not require payment of the loan within one year. (see Note 7).

7. Long-term Debt and other

Long-term debt and other consists of the following:

| October 31, | 2007 | 2006 |
|--|-------------------|-------------|
| Revolving credit borrowings (a) | \$ 138,278 | \$ 122,819 |
| Notes payable to the former stockholders of Northern Group, Inc. | | 2,999 |
| Capital lease obligations | 114 | 199 |
| Other | 731 | 1,499 |
| | 139,123 | 127,516 |
| Less current maturities | 209 | 3,242 |
| | \$ 138,914 | \$ 124,274 |

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars In Thousands)

(a) At October 31, 2007, the Company along with QKD, was part of a \$500,000 revolving line of credit with a syndicate of lenders (the Credit Agreement), which expires on April 30, 2010. The Credit Agreement provides for borrowings based on eligible accounts receivable and inventories and is secured by the Company's accounts receivable and inventories. The agreement provides the lenders with certain rights available to a secured lender. The interest rate applicable to borrowings under the Credit Agreement is based on, at QKD's option, the LIBOR rate or the prime rate. At October 31, 2007, substantially all of the revolving credit borrowings were at LIBOR, the effective rate of which approximated 6.58%. The borrowings under the Credit Agreement are classified as long-term based on the expiration date of the facility.

In connection with the Credit Agreement, the Company is required to maintain certain financial ratios and comply with certain restrictions. At October 31, 2007, the Company was in compliance with its financial covenants. As of February 1, 2008, the Company was not in compliance with its requirement to file its fiscal 2007 financial statements with the lender by January 31, 2008. Effective February 8, 2008 the Company received a waiver of non-compliance of this requirement from its lenders.

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Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)***(b)* Long term debt (exclusive of the revolving credit borrowings) is payable as follows:

| Year ending October 31, | |
|--------------------------------|--------|
| 2008 | \$ 209 |
| 2009 | 199 |
| 2010 | 185 |
| 2011 | 159 |
| 2012 | 93 |
| | \$ 845 |

8. Income Taxes

Provisions for federal, state and local income taxes (benefits) consists of the following:

| <i>Year ended October 31,</i> | 2007 | 2006 (Restated) | 2005 (Restated) |
|-------------------------------|-----------------|--------------------|--------------------|
| Current | | | |
| Federal | \$ 3,825 | \$ 5,440 | \$ 4,389 |
| State and local | 913 | 1,394 | 807 |
| | 4,738 | 6,834 | 5,196 |
| Deferred: | | | |
| Federal | 2,232 | 21 | (59) |
| State and local | 383 | (1) | (16) |
| | 2,615 | 20 | (75) |
| | \$ 7,353 | \$ 6,854 | \$ 5,121 |

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Model Reorg, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Dollars In Thousands)

Net deferred income tax asset, which is included in prepaids and other, consists of the following:

| <i>October 31,</i> | 2007 | 2006 |
|--------------------------------|-----------------|----------|
| Current: | | |
| Inventory valuation | \$ 1,739 | \$ 3,777 |
| Accounts receivable allowances | 107 | 106 |
| Depreciable assets | 121 | 420 |
| Other | 561 | 840 |
| | \$ 2,528 | \$ 5,143 |

Actual income tax expense differs from amounts computed by applying the United States federal income tax rate primarily as a result of state income taxes.

Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)****9. Proforma
Statements of
Income (unaudited)**

The Proforma statements of income (unaudited) include the operations of Jacavi for the years ended October 31, 2007 and 2006.

| Year ended October 31, | 2007 | 2006 |
|--|-------------------|-------------|
| Net sales, unaffiliated | \$ 313,369 | \$ 325,554 |
| Net sales, affiliated | 36,557 | 53,790 |
| Total net sales | 349,926 | 379,344 |
| Cost of goods sold | 255,486 | 279,183 |
| Gross Profit | 94,440 | 100,161 |
| Selling, warehouse, delivery and administrative expenses | 63,320 | 61,134 |
| Income from operations | 31,120 | 39,027 |
| Interest expense | 13,361 | 15,540 |
| Income before income taxes | 17,759 | 23,487 |
| Income taxes | 7,962 | 8,544 |
| Net income | \$ 9,797 | \$ 14,943 |

The above statements were prepared by combining Jacavi and the Company as if the Company acquired Jacavi as of November 1, 2005. The Proforma statements of income reflect (1) removal of the recovery and provision on vendor advances and (2) tax expense/benefit at the Company's effective tax rate.

Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)****10. Commitments
and
Contingencies***(a) Leases*

Total rent expense for warehouse space and equipment charged to operations for the years ended October 31, 2007, 2006, and 2005 was approximately \$4,195, \$2,702, and \$2,642 respectively. This includes allocated warehouse rent from QKD.

In January 2008 the Company began subleasing new office and warehouse facility from QKD at a rate of \$193 per month at an annual escalation of 3%. This sublease expires December 2027. Aggregate future minimum rental payments under operating leases are payable as follows:

| <i>Year ending October 31,</i> | |
|--------------------------------|------------------|
| 2008 | \$ 2,735 |
| 2009 | 3,118 |
| 2010 | 3,138 |
| 2011 | 2,503 |
| 2012 | 2,576 |
| Thereafter | 49,996 |
| | \$ 64,066 |

(b) Royalties

The Company is party to six license agreements with unaffiliated licensors. Royalty expense was \$2,542, \$2,638 and \$2,967 for the years ended October 31, 2007, 2006 and 2005, respectively. The aggregate future minimum payments under these licensing agreements at October 31, 2007 are payable as follows:

| <i>Year ending October 31,</i> | |
|--------------------------------|-----------------|
| 2008 | \$ 2,085 |
| 2009 | 1,975 |
| 2010 | 744 |
| 2011 | 400 |
| 2012 | 400 |
| | \$ 5,604 |

Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)***(c) Litigation*

The Company is a defendant in various lawsuits and claims which are in various stages of discovery and therefore no conclusions can be made by legal counsel as to their outcomes. It is the opinion of management that the outcome of these pending lawsuits and claims will not materially affect the operations or financial condition of the Company.

11. Statements of Cash Flows

Supplemental disclosure of cash flow information:

| <i>Year ended October 31,</i> | 2007 | 2006 | 2005 |
|---|-----------------|----------|----------|
| Cash paid during the year for: | | | |
| Income taxes | \$ 9,811 | \$ 5,556 | \$ 5,547 |
| Interest (excludes allocated interest from Affiliate) | \$ 8,548 | \$ 8,483 | \$ 5,941 |

Non-cash investing activities:

In connection with the acquisition of Jacavi in 2007, the Company issued 10.9 shares of common stock valued at approximately \$10.8 million to acquire Jacavi.

12. Major Customers

For the year ended October 31, 2007 one customer accounted for 15% of net sales. At October 31, 2007 accounts receivable relating to this customer was \$11,076. For the years ended October 31, 2006, and 2005, two customers, one being E Com, accounted for 27%, and 32% of net sales, respectively. At October 31, 2006, and 2005 accounts receivable relating to these two customers accounted for 40%, and 42% of accounts receivable, respectively.

13. Major Vendors

For the year ended October 31, 2007, two vendors accounted for 44% of net purchases, E Com being one of these vendors. At October 31, 2007 accounts payable relating to these vendors accounted for 40% of accounts payable. For the years ended October 31, 2006 and 2005, two vendors accounted for 42% and 26% of net purchases, respectively. At October 31, 2006 and 2005, accounts payable relating to these two vendors accounted for 63% and 18% of accounts payable, respectively.

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars In Thousands)

14. Acquisition

On October 5, 2007, the Company consummated an Agreement and Plan of Merger with Jacavi Holdings, Inc., a vendor of the Company, whereby the Company acquired 100% of the stock of Jacavi. In connection with the merger, the Company issued 10.9 shares of its common stock to the former shareholders of Jacavi. At the date of the acquisition, the operations of Jacavi were merged into Quality King Fragrance, Inc.

15. Subsequent Event

On December 21, 2007, the Company and its stockholders entered into an Agreement and Plan of Merger with E Com Ventures, Inc. whereby the Company will be merged into a newly formed wholly-owned acquisition subsidiary of E Com in exchange for the issuance of 5,900,000 shares of E Com's common stock and warrants to acquire an additional 1,500,000 common shares of E Com. The acquisition subsidiary will be the surviving entity and for accounting purposes, the Company will be the acquirer. The consummation of the Merger is subject to certain conditions, including shareholder approval, approval by NASDAQ of the listing of shares to be issued, and the availability of a new \$280 million secured credit facility to replace the Company's and E Com's existing third party credit facilities.

Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)****16. Segment Information**

Model Reorg operates in three industry segments, wholesale distribution, retail and manufacturing. Management reviews segment information by segment and on a consolidated basis each month. Model Reorg distributes fragrances to wholesalers and mass market retailers. Retail sales are made on a consignment basis at leased store locations. The manufacturing of owned and licensed brands is outsourced to third party fillers. The accounting policies for the segments are the same as those described in the Summary of Accounting Policies in the notes to the audited consolidated financial statements. Each of the segments has its own assets, liabilities, revenues and operating expenses.

| | Fiscal Year Ended October 31, | | |
|-----------------------|--------------------------------------|-------------------|-------------------|
| | 2007 | 2006 | 2005 |
| Net revenues: | | | |
| Wholesale | \$ 245,493 | \$ 257,826 | \$ 244,128 |
| Retail | 76,369 | 73,990 | 68,971 |
| Manufacturing | 5,850 | 6,545 | 3,808 |
| | \$ 327,712 | \$ 338,361 | \$ 316,907 |
| Gross profit: | | | |
| Wholesale | \$ 57,584 | \$ 59,886 | \$ 51,292 |
| Retail | 30,040 | 29,945 | 27,941 |
| Manufacturing | 2,885 | 3,206 | 2,227 |
| | \$ 90,509 | \$ 93,037 | \$ 81,460 |
| At October 31, | 2007 | 2006 | 2005 |
| Goodwill: | | | |
| Wholesale | \$ 27,176 | \$ 16,134 | \$ 15,893 |
| Retail | \$ 5,356 | \$ 5,356 | \$ 5,356 |

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Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(Dollars In Thousands)****17. Quarterly Financial Data (Unaudited)**

Unaudited summarized financial results for fiscal years ended October 31, 2007 and 2006 have been set forth below.

(\$ in thousands)

| | January 31, 2007 | April 30, 2007 | July 31, 2007 | October 31, 2007 |
|---------------------|-----------------------------|---------------------------|--------------------------|-----------------------------|
| 2007 QUARTER | | | | |
| Net Sales | \$ 102,481 | \$ 64,851 | \$ 67,553 | \$ 92,827 |
| Gross Profit | \$ 27,190 | \$ 20,745 | \$ 19,480 | \$ 23,094 |
| Net Income | \$ 3,760 | \$ 3,140 | \$ 1,656 | \$ 2,694 |
| | January 31, 2006 | April 30, 2006 | July 31, 2006 | October 31, 2006 |
| 2006 QUARTER | | | | |
| Net Sales | \$ 107,201 | \$ 63,016 | \$ 67,520 | \$ 100,624 |
| Gross Profit | \$ 29,248 | \$ 15,838 | \$ 18,962 | \$ 28,989 |
| Net Income (loss) | \$ 4,632 | \$ (430) | \$ 1,199 | \$ 4,640 |

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Table of Contents**Model Reorg, Inc. and Subsidiaries****Consolidated Balance Sheets****(Dollars In Thousands)**

| | April 30, 2008 (unaudited) | October 31, 2007 |
|---|-------------------------------|-------------------|
| Assets | | |
| Current: | | |
| Cash | \$ 5,136 | \$ 2,988 |
| Accounts receivable - net of allowances of \$132 and \$269 | 28,407 | 56,960 |
| Receivables from an affiliate | 35,844 | 25,484 |
| Inventories, net | 193,620 | 218,206 |
| Advances to suppliers for future purchases | 2,085 | 1,132 |
| Prepays and other | 5,724 | 7,554 |
| Total current assets | 270,816 | 312,324 |
| Property and equipment, at cost, less accumulated depreciation | 3,141 | 2,496 |
| Goodwill | 20,434 | 20,434 |
| Other assets, net | 12,146 | 9,734 |
| | \$ 306,537 | \$ 344,988 |
| Liabilities and Stockholders Equity | | |
| Current | | |
| Accounts payable - non affiliates | \$ 22,965 | \$ 30,882 |
| Accounts payable - affiliates | 144 | 2,152 |
| Accrued expenses | 9,276 | 9,359 |
| Other current liabilities | 2,935 | 2,548 |
| Current maturities of long-term debt | 208 | 209 |
| Total current liabilities | 35,528 | 45,150 |
| Long-term debt and other | 102,732 | 138,914 |
| Payable to affiliate | 76,912 | 76,313 |
| Total liabilities | 215,172 | 260,377 |
| Commitments and Contingencies | | |
| Stockholders equity | | |
| Common stock, no par value - 200 shares authorized 111 shares issued at October 31, 2007 and April 30, 2008 | 1 | 1 |
| Additional paid-in capital | 13,905 | 13,905 |
| Retained earnings | 78,934 | 72,180 |
| Treasury stock - 14 shares at cost | (1,475) | (1,475) |
| Total stockholders equity | 91,365 | 84,611 |
| | \$ 306,537 | \$ 344,988 |

See accompanying notes to consolidated financial statements

Table of Contents**Model Reorg, Inc. and Subsidiaries****Consolidated Statements of Income****(unaudited)****(Dollars In Thousands)**

| | Three Months Ended | | Six Months Ended | |
|---|---------------------------|-----------------------|-------------------------|-----------------------|
| | April 30, 2008 | April 30, 2007 | April 30, 2008 | April 30, 2007 |
| Net revenues, unaffiliated | \$ 55,663 | \$ 59,144 | \$ 156,902 | \$ 156,108 |
| Net revenues, affiliated | 6,370 | 5,707 | 19,685 | 11,224 |
| Total net revenues | 62,033 | 64,851 | 176,587 | 167,332 |
| Cost of goods sold, unaffiliated | 40,047 | 39,564 | 111,280 | 111,709 |
| Cost of goods sold, affiliated | 4,851 | 4,542 | 14,730 | 7,687 |
| Gross profit | 17,135 | 20,745 | 50,577 | 47,936 |
| Selling, warehouse, delivery and administrative expenses | 13,790 | 12,741 | 33,663 | 30,331 |
| Income from operations | 3,345 | 8,004 | 16,914 | 17,605 |
| Interest expense | 2,135 | 2,770 | 5,300 | 6,104 |
| Income before income taxes | 1,210 | 5,234 | 11,614 | 11,501 |
| Income taxes | 505 | 2,094 | 4,860 | 4,600 |
| Net income | \$ 705 | \$ 3,140 | \$ 6,754 | \$ 6,901 |

See accompanying notes to consolidated financial statements

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Model Reorg, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)
(Dollars In Thousands)

| | Six Months Ended April 30, | |
|---|----------------------------|-----------------|
| | 2008 | 2007 |
| Cash flows from operating activities: | | |
| Net income | \$ 6,754 | \$ 6,901 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 713 | 822 |
| Recovery for losses on accounts receivable | (89) | |
| Changes in assets and liabilities: | | |
| Decrease (increase) in: | | |
| Accounts receivable | 28,642 | 21,071 |
| Receivables from affiliate | (10,360) | (3,299) |
| Inventories | 24,586 | 28,742 |
| Advances to suppliers for future purchases | (953) | (3,308) |
| Prepays and other | 1,830 | (1,177) |
| (Decrease) increase in: | | |
| Accounts payable, non affiliates | (7,917) | (13,155) |
| Accounts payable, affiliates | (2,008) | |
| Accrued expenses and other liabilities | 304 | 1,289 |
| Total adjustments | 34,748 | 30,985 |
| Net cash provided by operating activities | 41,502 | 37,886 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (952) | (986) |
| Other investing activities | (2,819) | (255) |
| Net cash used in investing activities | (3,771) | (1,241) |
| Cash flows from financing activities: | | |
| Decrease in revolving credit borrowings | (36,081) | (22,148) |
| Proceeds from (repayment of) affiliated note payable | 599 | (13,234) |
| Payment of long-term debt and other | (101) | (1,635) |
| Payment of notes payable - former stockholder | | (158) |
| Net cash used in financing activities | (35,583) | (37,175) |
| Net increase (decrease) in cash | 2,148 | (530) |
| Cash, beginning of period | 2,988 | 2,737 |
| Cash, end of period | \$ 5,136 | \$ 2,207 |

See accompanying notes to consolidated financial statements

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

(Dollars In Thousands)

1. Summary of Accounting Policies (a) *Basis of Presentation*

The consolidated financial statements of Model Reorg, Inc. include the following wholly owned subsidiaries: Five Star Fragrance Co. Inc., Quality King Fragrance, Inc., Scents of Worth, Inc. and Jacavi, LLC (collectively the Company). The Company is an affiliate of Quality King Distributors, Inc. (QKD) and E Com Ventures, Inc. (E Com) through common ownership.

Effective October 2004, Model Reorg acquired all of the stock of Northern Group, Inc., (Northern), a fragrance distributor, for a total purchase price of \$11,998 in a business combination accounted for as a purchase. The results of operations of Northern are included in the accompanying consolidated financial statements as of the date of acquisition. Based on the fair values of the assets acquired and liabilities assumed, the Company recorded goodwill of \$9,392.

On October 5, 2007, the Company acquired all the stock of Jacavi, LLC (Jacavi) a fragrance distributor, in exchange for shares of Model Reorg common stock which was valued at approximately \$10,800. The acquisition was accounted for as a purchase and the results of operations of Jacavi are included in the accompanying consolidated financial statements as of the date of acquisition. In connection with the acquisition, the Company obtained a valuation of Jacavi from an independent company. Based on the fair value of the assets acquired and liabilities assumed, and the purchase consideration associated with the merger, the Company recorded goodwill of \$11,042, including \$242 of acquisition costs.

All significant intercompany balances and transactions have been eliminated.

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

(Dollars In Thousands)

(b) Organization and Business

The Company is primarily a promotional wholesale distributor of fragrances. Customers include traditional wholesalers, chain stores, mass merchandisers and retail wholesale clubs throughout the United States. In addition, the Company has arrangements with major retailers covering approximately 3,000 store locations and sells designer fragrances on consignment. The Company also manufactures fragrances that it owns or licenses from others.

(c) 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 that 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. Actual results could differ from those estimates and assumptions.

(d) Inventories

Inventories are valued at the lower of cost or market with cost being determined using the weighted average method, which approximates first-in, first-out (FIFO). Inventory reserves are based on the net realizable value of the inventory and are determined based on historical sales, aging of inventories and estimated marketability.

(e) Property and Equipment, and Depreciation

Depreciation is computed by the straight-line and accelerated methods over the estimated useful lives of the assets ranging primarily from three to seven years.

(f) Leased Property Under Capital Leases

Property under capital leases is amortized over the lives of the respective leases or the useful lives of the assets, whichever is shorter, ranging from five to ten years.

(g) Income Taxes

Model Reorg and subsidiaries are C corporations and provisions have been made for income tax expense at statutory rates.

The Company follows the liability method of accounting for income taxes. The primary objectives of accounting for income taxes are to recognize the amount of tax payable for the current year and recognize the amount of deferred tax asset or liability for the future tax consequences of events that have been reflected in the Company's financial statements or tax returns.

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

(Dollars In Thousands)

(h) Revenue Recognition

Sales are recognized when title passes, which occurs either upon shipment of products or sale to the ultimate customers from consignment inventories. Allowances for estimated returns and pricing adjustments are provided when sales are recognized and are recorded as a reduction of sales. Allowances provided for advertising, marketing and tradeshow are recorded as selling expenses since they are costs for services received from the customer which are separable from the customer's purchase of the Company's products. Accruals and allowances are estimated based on available information including third party data.

(i) Concentrations of Credit Risk

The Company is potentially subject to a concentration of credit risk with respect to its trade receivables, the majority of which are due from retailers and wholesale distributors. Credit risks also relate to the seasonal nature of the business. The Company's sales are concentrated in November and December for the holiday season. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. The Company maintains allowances to cover potential or anticipated losses for uncollectible accounts. The Company maintains credit insurance on certain receivables, which minimizes the financial impact of uncollectible accounts.

2. Inventories

Inventories, which are primarily comprised of finished products, are shown net of reserves for obsolescence and market write downs. Reserves at April 30, 2008 and October 31, 2007 were \$2,976 and \$2,968, respectively.

3. Related Party Transactions

(a) The Company receives services from QKD and E Com pursuant to service agreements. The agreement with QKD provides for the allocation of expenses, which are calculated based on various assumptions and methods. The methods employed utilize various allocation bases including the number of transactions processed, estimated delivery miles, warehouse square footage, payroll dollars and sales and inventory ratios. Allocated operating expenses for the three and six months ended April 30, 2008 were \$1.8 million and \$4.9 million or 13.3% and 35.4% of total operating expenses, as compared to \$3.0 million and \$6.0 million or 24.4% and 46.8% of total operating expense for the three and six months ended April 30, 2007.

Allocated interest expense represents interest expense on the Company's revolving credit borrowings and is allocated at the same effective rate as in the QKD Credit Agreement.

The Company believes that the allocated expenses are reasonable and approximate those expenses that would have been incurred had the Company not operated under a service agreement.

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

(Dollars In Thousands)

(b) On August 2, 2007 the Company entered into a service agreement with E Com whereby E Com provides IT Management Support services for all of the Company's computer systems at a rate of \$25 per month, plus out of pocket expenses. This agreement will terminate at consummation of the Company's merger with E Com or January 29, 2009, if the merger has not been finalized.

(c) The Company had sales and purchase transactions with E Com as follows: sales for the three and six months ended April 30, 2008 were \$6,370 and \$19,685, respectively, and for the three and six months ended April 30, 2007, \$5,707 and \$11,224, respectively. Purchases for the three and six months ended April 30, 2008 were \$9,802 and \$21,088, respectively, and for the three and six months ended April 30, 2007 \$5,707 and \$8,128, respectively. The Company had a receivable balance from this affiliate of \$35,844, and \$25,484 at April 30, 2008 and October 31, 2007, respectively. The Company had a payable balance to this affiliate of \$144 and \$2,152 at April 30, 2008 and October 31, 2007, respectively.

(d) Effective January 2008, the Company began subletting new office and warehouse space from QKD (see Note 4).

(e) Included in other current liabilities is deferred compensation due to an officer. The Company's liability is calculated by a formula and totals \$1.9 million and \$1.5 million at April 30, 2008 and October 31, 2007, respectively.

(f) On December 21, 2007, the Company and its stockholders entered into an Agreement and Plan of Merger with E Com Ventures, Inc. whereby the Company will be merged into a newly formed wholly-owned Acquisition Sub of E Com in exchange for the issuance of 5,900,000 shares of E Com's common stock and warrants to acquire an additional 1,500,000 common shares of E Com. The Acquisition Sub will be the surviving entity and for accounting purposes, the Company will be the acquirer. The consummation of the Merger is subject to certain conditions, including shareholder approval, approval by NASDAQ of the listing of shares to be issued, and the availability of a new secured credit facilities to replace the Company's and E Com's existing third party credit facilities. A commitment has been obtained from a lender on May 16, 2008 for a senior credit facility of \$250 million.

4. Commitments and Contingencies

(a) *Leases*

Total rent expense for warehouse space and equipment charged to operations for the three and six months ended April 30, 2008 was approximately \$1,219 and \$2,700, respectively and for the three and six months ended April 30, 2007 was approximately \$848 and \$1,663, respectively. This includes allocated warehouse rent from QKD.

In January 2008 the Company began subleasing new office and warehouse facility from QKD at a rate of \$193 per month at an annual escalation of 3%. This sublease expires December 2027.

Table of Contents**Model Reorg, Inc. and Subsidiaries****Notes to Consolidated Financial Statements****(unaudited)****(Dollars In Thousands)***(b) Litigation*

The Company is a defendant in various lawsuits and claims which are in various stages of discovery and therefore no conclusions can be made as to their outcomes. Management believes that the outcome of these pending lawsuits and claims will not materially affect the operations, financial condition or cash flow of the Company.

5. Segment Information

Model Reorg operates in three industry segments, wholesale distribution, retail and manufacturing. Management reviews segment information by segment and on a consolidated basis each month. Model Reorg distributes fragrances to wholesalers and mass market retailers. Retail sales are made on a consignment basis at leased store locations. The manufacturing of owned and licensed brands is outsourced to third party fillers. The accounting policies for the segments are the same as those described in the Summary of Accounting Policies in the notes to the audited Consolidated Financial Statements. Each of the segments has its own assets, liabilities, revenues, and operating expenses.

| | Three Months Ended | | Six Months Ended | |
|----------------------|---------------------------|-----------------------|-------------------------|-----------------------|
| | April 30, 2008 | April 30, 2007 | April 30, 2008 | April 30, 2007 |
| Net revenues: | | | | |
| Wholesale | \$ 45,730 | \$ 49,141 | \$ 128,297 | \$ 120,140 |
| Retail | 15,299 | 14,705 | 45,661 | 45,170 |
| Manufacturing | 1,004 | 1,005 | 2,629 | 2,022 |
| | \$ 62,033 | \$ 64,851 | \$ 176,587 | \$ 167,332 |
| Gross profit: | | | | |
| Wholesale | \$ 10,916 | \$ 14,640 | \$ 32,022 | \$ 29,764 |
| Retail | 5,884 | 5,811 | 17,642 | 17,341 |
| Manufacturing | 335 | 294 | 913 | 831 |
| | \$ 17,135 | \$ 20,745 | \$ 50,577 | \$ 47,936 |

Goodwill for the wholesale and retail segments was \$27,176 and \$5,356 respectively, at both April 30, 2008 and October 31, 2007.

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

(Dollars In Thousands)

6. New Accounting Pronouncements

In December 2007, the FASB issued SFAS No, 141(R), Business Combinations (SFAS 141(R)). SFAS 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, the goodwill acquired, and any noncontrolling interest in the acquiree. This statement also establishes disclosure requirements to enable the evaluation of the nature and financial effect of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. We are in the process of evaluating the effect the adoption of SFAS 141(R) will have on our results of operations, financial position and cash flows.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. (SFAS 159). SFAS 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective for fiscal year ended October 31, 2009. The adoption of SFAS 159 did not have any effect on our results of operations, financial position and cash flows.

In September 2006, the FASB issued SFAS 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements and, accordingly, does not require any new fair value measurements. SFAS 157 is effective for the first interim period beginning in fiscal 2008 for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis in financial statements. In November 2007, the FASB provided a one year deferral for the implementation of SFAS 157 for other nonfinancial assets and liabilities. We do not expect the adoption of SFAS 157 to have a material effect on our results of operations, financial position and cash flows.

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Model Reorg, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

(Dollars In Thousands)

In June 2006, the FASB issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized under SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on various related matters such as derecognition, interest and penalties, and disclosure. The effective date of FIN 48 for non-public enterprises is for annual periods beginning after December 15, 2007. The Company has begun evaluating the financial impact of applying the provisions of FIN 48 to all tax positions and it does not believe there will be a material financial impact upon the initial adoption of FIN 48.

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Annex I

AGREEMENT AND PLAN OF MERGER

among

Model Reorg, Inc.,

the stockholders of Model Reorg, Inc.,

E Com Ventures, Inc.

and

Model Reorg Acquisition LLC

Dated as of December 21, 2007

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Proxy Statement Exhibit

Notice about Representations and Warranties Herein

This Agreement is included as an exhibit to E Com Ventures, Inc.'s Proxy Statement to provide information about the terms of the contractual arrangement between the parties with respect to the Merger described herein, but its filing is not intended to provide factual information about the parties to any other person. The representations and warranties contained in this Agreement were made only for purposes of this Agreement and as of specific dates, were solely for the benefit of the parties hereto, and are subject to limitations agreed to between the contracting parties, including that they are qualified by disclosures between the parties. These representations and warranties may have been made for the purposes of allocating contractual risk between the parties to the Agreement instead of establishing these matters as facts, and may be subject to standards of materiality applicable to the contracting parties that differ from those applicable to disclosures to investors. They should be viewed by investors in this context. Accordingly, investors and third parties should not rely on these representations and warranties as independent characterizations of the actual state of facts at the time they were made or otherwise but should consider them together with the other information in this Proxy Statement or that we have disclosed in other filings with the SEC.

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AGREEMENT AND PLAN OF MERGER

This AGREEMENT AND PLAN OF MERGER, dated as of December 21, 2007 (this Agreement), is by and among Model Reorg, Inc., a New York corporation (Model), the stockholders of Model set forth on Schedule 2.7 (the Model Shareholders), E Com Ventures, Inc., a Florida corporation (E Com), and Model Reorg Acquisition LLC, a Delaware limited liability company and wholly-owned subsidiary of E Com (Acquisition Sub). Certain terms used in this Agreement are used as defined in Section 9.11.

Recitals

Each of the respective Boards of Directors of E Com and Model deems it advisable that Acquisition Sub acquire Model on the terms and subject to the conditions provided for in this Agreement;

In furtherance thereof, it is proposed that such acquisition be accomplished by the merger of Model with and into Acquisition Sub, with Acquisition Sub being the surviving entity, in accordance with the Business Corporation Law of the State of New York (the BCL) and the Delaware Limited Liability Company Act (the DLLCA), pursuant to which all of the shares of common stock, no par value, of Model (the Model Common Stock) issued and outstanding will be converted into the right to receive an aggregate of 5,900,000 shares of common stock, \$.01 par value of E Com (the E Com Common Stock) and Common Stock Warrants Purchase Warrants to acquire 1,500,000 shares of E Com Common Stock in the form of Exhibit A attached hereto (the Warrants) and, together with such shares of E Com Common Stock, the Merger Consideration), on the terms and subject to the conditions provided for in this Agreement, and such surviving entity will be a wholly-owned subsidiary of E Com (the Merger); and

The respective Boards of Directors of E Com and Model have adopted, the sole member of Acquisition Sub has approved and the shareholders of Model have each approved this Agreement and the Merger.

Agreements

NOW, THEREFORE, in consideration of the representations, warranties, covenants and agreements contained in this Agreement, and intending to be legally bound hereby, E Com, Acquisition Sub and Model hereby agree as follows:

ARTICLE 1 - PRELIMINARY ACTIONS

1.1 Preliminary Actions. As soon as practicable following the date hereof, E Com, acting through its Board of Directors, shall, in accordance with all applicable laws, statutes, ordinances, codes, rules, regulations, decrees and orders of any Governmental Entity (collectively, Laws) and its current certificate of incorporation and by-laws:

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(a) duly call, give notice of, convene and hold an annual or special meeting of E Com s shareholders (the Shareholders Meeting) for the purposes of obtaining the affirmative vote of E Com s shareholders in favor of (i) the issuance of E Com Common Stock and the Warrants pursuant to the Merger and the issuance of E Com Common Stock upon exercise of the Warrants, as required under applicable Law and Nasdaq Market Place Rule 4350(i)(1)(C) and Section 6.1(a) and (ii) the amendment of the certificate of incorporation of E Com (the Charter Amendment) to increase the number of shares of E Com Common Stock that E Com is authorized to issue to 20,000,000 shares (together, the E Com Shareholder Approval) and in favor of the change of the E Com s name to Perfumania Holdings, Inc. ; and

(b) in consultation with Model, prepare and file with the SEC a preliminary proxy statement relating to the E Com Shareholder Approval and obtain and furnish the information required by the SEC to be included therein and, after consultation with Model, respond promptly to any comments made by the staff of the SEC with respect to the preliminary proxy statement and cause a definitive proxy statement (together with all amendments, supplements and exhibits thereto, the Proxy Statement) to be mailed to E Com s shareholders at the earliest practicable date; provided that no amendments or supplements to the Proxy Statement shall be made by E Com without consultation with Model.

1.2 Proxy Statement. Without limiting any other provision of this Agreement, whenever any party hereto becomes aware of any event or change which is required to be set forth in an amendment or supplement to the Proxy Statement, such party shall promptly inform the other parties thereof and each of the parties shall cooperate in the preparation, filing with the SEC and (as and to the extent required by applicable federal and state securities laws) dissemination to E Com s shareholders of such amendment or supplement. Model shall provide E Com with such information with respect to Model and its affiliates as shall be required to be included in the Proxy Statement.

ARTICLE 2 - THE MERGER

2.1 The Merger. Upon the terms and subject to the conditions set forth in this Agreement, and in accordance with the BCL and the DLLCA, at the Effective Time Model shall merge with and into Acquisition Sub, and the separate corporate existence of Model shall thereupon cease, and Acquisition Sub shall be the surviving entity in the Merger (the Surviving Entity).

2.2 Closing. The closing of the Merger (the Closing) shall take place at 10:00 a.m. (New York City time) at the offices of Edwards Angell Palmer & Dodge LLP, 750 Lexington Avenue, New York, New York, on a date to be specified by the parties, which date shall be no later than the second Business Day after satisfaction or waiver of the conditions set forth in Article 6 (other than conditions that by their nature are to be satisfied at the Closing, but subject to the satisfaction or waiver of such conditions), unless another time, place or date, or any or all, are agreed to in writing by the parties hereto. The date on which the Closing is held is herein referred to as the Closing Date .

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2.3 **Effective Time**. Subject to the provisions of this Agreement, on the Closing Date the parties shall file certificates of merger with the Department of State of the State of New York and the Secretary of State of the State of Delaware pursuant to the applicable provisions of the BCL and the DLLCA (each, the Certificate of Merger), executed in accordance with the relevant provisions of the BCL and the DLLCA, and shall make all other filings or recordings required under the BCL and the DLLCA in order to effect the Merger, in each case in forms approved by E Com and Model, which approval shall not be unreasonably withheld. The Merger shall become effective upon the filing of the second of the Certificates of Merger or at such other time as is agreed by the parties hereto and specified in the Certificates of Merger (the time at which the Merger becomes effective is herein referred to as the Effective Time).

2.4 **Effects of the Merger**. From and after the Effective Time, the Merger shall have the effects set forth in the BCL and the DLLCA. Without limiting the generality of the foregoing, and subject thereto, at the Effective Time, all the properties, rights, privileges, powers and franchises of Model and Acquisition Sub shall vest in the Surviving Entity, and all debts, duties and liabilities of Acquisition Sub and Model shall become the debts, liabilities and duties of the Surviving Entity.

2.5 **Certificate of Formation and Limited Liability Company Agreement of the Surviving Entity**. The certificate of formation and limited liability company agreement of Acquisition Sub shall be applicable to the Surviving Entity until thereafter amended as provided by law and such certificate of formation and limited liability company agreement.

2.6 **Managers and Officers of the Surviving Entity**. The managers and officers of Acquisition Sub immediately prior to the Effective Time shall be the managers and officers of the Surviving Entity until their respective successors are duly elected or appointed and qualified or their earlier death, resignation or removal in accordance with the limited liability company agreement of the Surviving Entity.

2.7 **Conversion of Securities**. At the Effective Time, by virtue of the Merger and without any action on the part of the holders of any securities of Acquisition Sub or Model:

(a) The issued and outstanding shares of Model Common Stock at the Effective Time shall be converted into and become an aggregate of 5,900,000 validly issued, fully paid and nonassessable shares of E Com Common Stock and the Warrants. The E Com Common Stock and the Warrants included in the Merger Consideration shall be allocated among the Model Shareholders as set forth on Schedule 2.7 attached hereto.

(b) Any shares of Model Common Stock that are owned by Model as treasury stock shall be automatically canceled and retired and shall cease to exist and no consideration shall be delivered in exchange therefor.

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(c) Each outstanding membership interest of Acquisition Sub shall remain issued, outstanding and unchanged and owned by E Com.

2.8 Status of Certificates.

(a) Transfer Books; No Further Ownership Rights in Company Stock. The Merger Consideration to be paid in respect of shares of Model Common Stock shall be paid upon the surrender or exchange of stock certificates representing shares of Model Common Stock (collectively, the Certificates) in accordance with the terms of this Article 2 and shall be deemed to have been paid in full satisfaction of all rights pertaining to the shares of Model Common Stock previously represented by such Certificates. At the Effective Time, the stock transfer books of Model shall be closed and thereafter there shall be no further registration of transfers of shares of Model Common Stock on the records of Model, except for the cancellation of such shares in connection with the Merger. From and after the Effective Time, the holders of Certificates that evidenced ownership of shares of Model Common Stock outstanding immediately prior to the Effective Time shall cease to have any rights with respect to such shares, except as otherwise provided for herein or by applicable Law. If, after the Effective Time, bona fide Certificates are presented to the Surviving Entity for any reason, they shall be canceled and exchanged as provided in this Article 2.

(b) Lost, Stolen or Destroyed Certificates. If any Certificate shall have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the Person claiming such Certificate to be lost, stolen or destroyed and, if required by E Com, the posting by such Person of a bond, in such reasonable amount as E Com may direct, as indemnity against any claim that may be made against it with respect to such Certificate, E Com will pay, in exchange for such lost, stolen or destroyed Certificate, the applicable Merger Consideration to be paid in respect of the shares of Model Common Stock formerly represented by such Certificate, as contemplated by this Article 2, in which event such Certificate shall be deemed cancelled.

2.9 Escrow Fund.

At the Closing, E Com shall retain and not deliver to the Model Shareholders certificates representing 295,000 shares of the Merger Consideration (the Escrow Shares , including all dividends, distributions or earnings attributable thereto, collectively, the Escrow Fund) subject to the terms hereof for the purpose of securing the indemnification rights of E Com under this Agreement, such Escrow Shares being allocated among the holders of Model Common Stock as set forth on Schedule 2.7. After the Closing, E Com shall act as escrow agent (the Escrow Agent) with respect to the Escrow Fund. Any dividends, distributions or earnings on the Escrow Shares held in the Escrow Fund shall be deposited by the Escrow Agent in an interest bearing bank account established by the Escrow Agent for such purpose. The Escrow Agent shall comply with the procedures pertaining to the Escrow Fund and any disputes related thereto as set forth in Article 8 below. Voting rights to the Escrow Shares shall be exercisable by or on behalf of the Model Shareholders in proportion to the respective allocations of the Escrow Shares. On the thirtieth (30th) day following the filing of E

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Com's first Annual Report on Form 10-K with the SEC following the Closing that includes audited financial statements that reflect at least six (6) months of the operations of the Surviving Entity, or if such day shall not be a Business Day on the next succeeding Business Day (the Escrow Release Date), the Escrow Agent will deliver the remaining shares of E Com Common Stock in the Escrow Fund, if any, and any dividends, distributions or earnings with respect to such Escrow Shares then held in the Escrow Fund and accrued interest thereon, to the Model Shareholders pro rata based upon their respective allocations of the Escrow Shares; provided, however, that subject to and in accordance with the terms of Article 8, the Escrow Agent shall withhold from delivery of the Escrow Fund such number of Escrow Shares as shall have a value, based upon the Consideration Per Share Price, equal to any amounts then in dispute relating to indemnification obligations arising under this Agreement, provided further that the withheld Escrow Shares, to the extent not applied in satisfaction of indemnification obligations pursuant to Article 8, shall be delivered to the Model Shareholders pro rata based upon their respective allocations of the Escrow Shares upon resolution of such dispute.

ARTICLE 3 - REPRESENTATIONS AND WARRANTIES OF E COM

E Com represents and warrants to Model that, except as set forth in the disclosure letter delivered by E Com to Model simultaneously with the execution of this Agreement (the E Com Disclosure Schedule):

3.1 Organization.

(a) E Com is a corporation duly organized, validly existing and in good standing under the laws of the State of Florida and has the requisite corporate power and authority necessary to own or lease all of its properties and assets and to carry on its business as it is now being conducted. E Com is duly licensed or qualified to do business and is in good standing in each jurisdiction in which the nature of the business conducted by it or the character or location of the properties and assets owned or leased by it makes such licensing or qualification necessary, except where the failure to be so licensed, qualified or in good standing would not reasonably be expected to have a Material Adverse Effect on E Com and would not reasonably be expected to prevent or delay E Com's performance of its obligations under this Agreement.

(b) Each of E Com's Subsidiaries, including without limitation Acquisition Sub, listed on Section 3.1(b) of the E Com Disclosure Schedule is duly organized, validly existing and in good standing under the laws of the jurisdiction of its organization and has the requisite power and authority to own or lease all of its properties and assets and to carry on its business as it is now being conducted. Acquisition Sub has not filed an election under Treasury Regulation 301.7701-3 to be classified other than as provided in Treasury Regulation Section 301.7701-3(b) or any similar provision of state, local or foreign law, and shall not make such election prior to the Effective Time. Acquisition Sub has never had greater than one owner at any time during its existence, or had any owner other than its current owner, and agrees that such owner shall not be changed or added to prior to the Effective Time. E Com has made

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available to Model a complete and correct copy of the certificates of incorporation or formation, and by-laws or limited liability company agreements (or comparable documents), each as amended to date, of each such Subsidiary. Each Subsidiary is duly licensed or qualified to do business and is in good standing in each jurisdiction in which the nature of the business conducted by it or the character or location of the properties and assets owned or leased by it makes such licensing or qualification necessary, except where the failure to be so licensed, qualified or in good standing would not reasonably be expected to have a Material Adverse Effect with respect to E Com. Other than the Subsidiaries listed on Section 3.1(b) of the E Com Disclosure Schedule, E Com does not have any Subsidiaries, and does not own, directly or indirectly, any equity securities or other interests or capital stock of any Person.

3.2 Capitalization.

The authorized capital stock of E Com consists of 6,250,000 shares, \$0.01 par value, of E Com Common Stock and 1,000,000 shares, \$0.10 par value, of preferred stock of E Com. At the close of business on December 20, 2007, there were 3,059,041 shares of E Com Common Stock and no shares of preferred stock of E Com issued and outstanding, and 898,249 shares were held by E Com in its treasury. As of December 20, 2007, there were 144,696 shares of E Com Common Stock reserved for issuance upon the exercise of outstanding options under the Stock Plans and 444,445 shares of E Com Common Stock reserved for issuance upon the conversion of the Company's \$5,000,000 Subordinated Promissory Note dated December 9, 2004 payable to the order to Stephen Nussdorf and Glenn Nussdorf. For purposes of this Agreement, Stock Plans shall mean the following plans of E Com: the 2000 Stock Option Plan, the Directors 2000 Stock Option Plan, and any other stock option plan, program or arrangement providing for the issuance or grant of any other interest in respect of the capital stock or equity of E Com. All E Com capital stock, voting securities and equity interests have been duly authorized and validly issued and are fully paid, nonassessable and free of preemptive rights. Except as set forth above, E Com does not have outstanding any shares of its capital stock, voting securities or equity interests or any options, warrants, convertible or exchangeable securities or rights that may result in the issuance of any shares of capital stock, voting securities or equity interests of E Com, including, without limitation, any right to purchase E Com Common Stock, phantom stock rights, stock appreciation right or stock based performance units. Section 3.2(a) of the E Com Disclosure Schedule includes a list of all outstanding options and warrants to purchase E Com Common Stock, the holders thereof and the related exercise prices thereof.

3.3 Authority.

(a) Each of E Com and Acquisition Sub has all necessary corporate, in the case of E Com, and limited liability company, in the case of Acquisition Sub, power and authority to execute and deliver this Agreement, the Warrants and the Registration Rights Agreement to the extent it is a party thereto and, subject, in the case of E Com, to obtaining E Com Shareholder Approval. The execution, delivery and performance by each of E Com and Acquisition Sub of this Agreement, the Warrants and the Registration

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Rights Agreement to the extent it is a party thereto, and the consummation by each of the Transactions, have been duly authorized and approved by the Board of Directors of E Com, the Board of Managers of Acquisition Sub and the sole member of Acquisition Sub.

(b) The Special Committee, at a meeting duly called and held, has unanimously approved the Transactions and recommended the adoption of this Agreement to the Board of Directors of E Com, subject to the right of the Special Committee to withdraw, modify or amend such recommendation if the Special Committee determines, in good faith, that failure to take such action would be reasonably likely to result in a breach of its fiduciary duties to E Com's shareholders under applicable Law.

(c) E Com's Board of Directors, at a meeting duly called and held, has duly adopted resolutions: (i) determining that the terms of the Merger are fair from a financial point of view to the holders of E Com Common Stock (other than shareholders of E Com who own, or whose Affiliates own, securities of Model), (ii) adopting this Agreement and declaring advisable this Agreement and the Transactions and (iii) recommending that the shareholders of E Com approve the issuance of shares of E Com Common Stock and the Warrants pursuant to the Merger and the issuance of E Com Common Stock upon exercise of the Warrants, subject to the right of the Board of Directors of E Com to withdraw, modify or amend such recommendation to the extent that the Board of Directors of E Com determines, in good faith, that failure to take such action would be reasonably likely to result in a breach of its fiduciary duties to E Com's shareholders under applicable Law.

(d) Except for the E Com Shareholder Approval in the case of E Com, no corporate action not yet taken on the part of E Com or Acquisition Sub is necessary to authorize the execution, delivery and performance by E Com or Acquisition Sub of this Agreement, the Warrants and the Registration Rights Agreement to the extent it is a party thereto and the consummation by each of the Transactions. This Agreement has been duly executed and delivered by each of E Com and Acquisition Sub and constitutes and, following their execution and delivery by the parties thereto, each Warrant and Registration Rights Agreement will each constitute, a valid and binding obligation of E Com and Acquisition Sub, to the extent it is a party thereto, enforceable against E Com or Acquisition Sub, as applicable, in accordance with its terms, except that such enforceability may be limited by applicable bankruptcy, insolvency, fraudulent transfer, moratorium or other similar laws of general application affecting or relating to the enforcement of creditors' rights generally (the Bankruptcy Exception).

3.4 Opinion of Financial Advisor. The Special Committee has received the opinion of Financo, Inc., dated the date of this Agreement, to the effect that, as of such date, and subject to the various assumptions and qualifications set forth therein, the consideration to be paid by E Com in the Merger is fair to the shareholders of E Com (other than shareholders of E Com who own or whose Affiliates own securities of Model) from a financial point of view.

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3.5 Finders or Brokers. Except for Financo, Inc., no broker, investment banker, financial advisor or other Person is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with the Transactions based upon arrangements made by or on behalf of E Com or any of its Subsidiaries.

ARTICLE 4 - REPRESENTATIONS AND WARRANTIES OF MODEL

Model represents and warrants to E Com and Acquisition Sub that, except as set forth in the disclosure letter delivered by Model to E Com and Acquisition Sub simultaneously with the execution of this Agreement (the Model Disclosure Schedule):

4.1 Organization.

(a) Model is a corporation duly organized, validly existing and in good standing under the laws of the State of New York and has the requisite corporate power and authority necessary to own or lease all of its properties and assets and to carry on its business as it is now being conducted. Model has made available to E Com a complete and correct copy of its certificate of incorporation and by-laws as amended to date (the Model Charter Documents). Model is duly licensed or qualified to do business and is in good standing in each jurisdiction in which the nature of the business conducted by it or the character or location of the properties and assets owned or leased by it makes such licensing or qualification necessary, except where the failure to be so licensed, qualified or in good standing would not reasonably be expected to have a Material Adverse Effect with respect to Model and would not reasonably be expected to prevent or delay Model's performance of its obligations under this Agreement.

(b) Section 4.1(b) of the Model Disclosure Schedule sets forth a true and complete list of all of Model's Subsidiaries. Each of Model's Subsidiaries is duly organized, validly existing and in good standing under the laws of the jurisdiction of its organization and has the requisite power and authority to own or lease all of its properties and assets and to carry on its business as it is now being conducted. Each such Model Subsidiary is duly licensed or qualified to do business and is in good standing in each jurisdiction in which the nature of the business conducted by it or the character or location of the properties and assets owned or leased by it makes such licensing or qualification necessary, except where the failure to be so licensed, qualified or in good standing would not reasonably be expected to have a Material Adverse Effect with respect to Model. Other than the Subsidiaries listed on Section 4.1(b) of the Model Disclosure Schedule, Model does not have any Subsidiaries, and does not own, directly or indirectly, any equity securities or other interests or capital stock of any Person.

4.2 Capitalization.

The authorized capital stock of Model consists of 200 shares of Model Common Stock. There are 96.90 shares of Model Common Stock issued and outstanding, and no shares were held by Model in its treasury. Except therefor, Model does not have any outstanding shares of capital stock, voting securities or equity interests or any options, warrants, convertible or exchangeable securities or rights that may result in the issuance of any shares of capital stock, voting securities or equity interests of Model, including, without

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limitation, any right to purchase Model Common Stock, phantom stock rights, stock appreciation right or stock based performance units. There are no agreements which would obligate Model (whether by the terms of the creating instrument or upon the demand or request of the holder thereof) to issue or repurchase any of its capital stock.

4.3 Authority.

(a) Model has all necessary corporate power and authority to execute and deliver this Agreement and to perform its obligations hereunder and to consummate the Transactions. This Agreement has been duly and unanimously adopted by Model's Board of Directors. The execution, delivery and performance by Model of this Agreement, and the consummation by it of the Transactions, have been duly authorized and approved by its Board of Directors.

(b) Model's Board of Directors, at a meeting duly called and held, has duly adopted resolutions (i) adopting this Agreement and authorizing the Transactions and (iii) recommending that the Model Shareholders approve this Agreement.

(c) This Agreement has been duly adopted and authorized by the unanimous vote or written consent of the holders of all of the outstanding shares of Model Common Stock, which is the only vote or approval of the holders of any class or series of capital stock of Model or any of its Subsidiaries which is necessary to adopt and authorize this Agreement and approve and authorize the Transactions.

(d) No other corporate action on the part of Model is necessary to authorize the execution, delivery and performance by Model of this Agreement and the consummation of the Transactions. This Agreement has been duly executed and delivered by Model and constitutes a valid and binding obligation of Model, enforceable against it in accordance with its terms, subject to the Bankruptcy Exception.

4.4 Consents and Approvals; No Violations.

(a) Except for (i) the filing of the Certificates of Merger with the Department of State of the State of New York and the Secretary of State of the State of Delaware pursuant to the BCL and the DLLCA, respectively, and (ii) applicable requirements of the Hart-Scott-Rodino Act (the HSR Act) and similar applicable competition, antitrust or similar Laws in any relevant foreign country or jurisdiction, no consents or approvals of, or filings, declarations or registrations with, any Governmental Entity are necessary for the consummation by Model of the Transactions, other than such other consents, approvals, filings, declarations or registrations that, if not obtained, made or given, would not reasonably be expected to have a Material Adverse Effect with respect to Model.

(b) Neither the execution and delivery of this Agreement by Model, nor the consummation by Model of the Transactions, nor compliance by Model with any of the terms or provisions hereof, will (i) conflict with or violate any provision of Model's

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certificate of incorporation or by-laws, each as amended, or (ii) assuming that the authorizations, consents and approvals referred to in Section 4.4(a) of the Model Disclosure Schedule are obtained and the filings referred to in Section 4.4(a) of the Model Disclosure Schedule are made, violate any Law or any judgment, writ or injunction of any Governmental Entity applicable to Model or any of its Subsidiaries, or (iii) assuming that the notices and consents set forth on Section 4.4(b) of the Model Disclosure Schedule are made or obtained, violate, conflict with or constitute a default (or an event, condition or circumstance which, with notice or lapse of time, would become a default) under, or give any rights of termination or cancellation of, or accelerate the performance required by, or maturity of, or result in the creation of any encumbrance on any assets of Model or its Subsidiaries pursuant to the terms, conditions or provisions of any note, bond, mortgage, indenture, deed of trust, license, lease, contract, Permit, franchise, concession or other agreement to which Model or any of its Subsidiaries is a party, or by which any of their assets are bound, except, with respect to clauses (ii) and (iii), for violations, conflicts or defaults or other occurrences which would not have a Material Adverse Effect on Model.

4.5 Undisclosed Liabilities, Etc.

(a) The audited consolidated financial statements of Model as of and for the years ended October 31, 2004, 2005 and 2006 and unaudited consolidated financial statements of Model as of and for the eleven months ended September 30, 2007 (the Model Financial Statements) have been prepared in accordance with GAAP, and fairly present in all material respects the consolidated financial position of Model and its consolidated Subsidiaries as of the dates thereof and the consolidated results of their operations and cash flows for the periods then ended (subject, in the case of unaudited quarterly statements, to normal year-end audit adjustments).

(b) Neither Model nor any of its Subsidiaries has any material liabilities of any nature, whether accrued, absolute, contingent, direct, indirect or otherwise, which, if known, would be required to be reflected or reserved against on a consolidated balance sheet of Model prepared in accordance with GAAP or the notes thereto, except liabilities (i) reflected or reserved against on the balance sheet of Model and its Subsidiaries as of September 30, 2007 (the Model Balance Sheet Date) (including the notes thereto, the Model Balance Sheet), (ii) incurred after the Model Balance Sheet Date in the ordinary course of business consistent with past practice, or (iii) reflected on the Model Disclosure Schedule. The reserves, if any, reflected on the Model Balance Sheet and the Model Financial Statements are adequate, appropriate and reasonable for their purposes, including without limitation, litigation reserves and product warranty reserves, if any.

(c) The accounts receivable shown on the Model Balance Sheet arose from bona fide transactions in the ordinary course of business. The accounts receivable of Model and its Subsidiaries arising after the Model Balance Sheet Date and prior to the Closing Date arose, or will arise, from bona fide transactions in the ordinary course of business. Except as reserved on the Model Balance Sheet, none of such accounts receivable is subject to any claim of offset or recoupment or counterclaim, and Model has no

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Knowledge of any specific facts that would be likely to give rise to any such claim. Except as reserved on the Model Balance Sheet, no amount of such accounts receivable is contingent upon the performance by Model or any of its Subsidiaries of any obligation and no agreement for deduction or discount or any type of credit has been made with respect to any such accounts receivable. Except as reserved on the balance sheet, to the Knowledge of Model, no account debtor of Model or any of its Subsidiaries has proposed any discount or reduction with respect to such account debtor s accounts receivable.

(d) All inventories of Model and its Subsidiaries consist of a quality and quantity usable and salable in the ordinary course of business, except for obsolete items and items of below standard quality which have been written off or written down to net realizable value in the Model Balance Sheet. All inventories (other than as so written off) of Model and it Subsidiaries have been included in the Model Balance Sheet at the lower of cost or market (net realizable value) on an average cost basis. The quantities of inventories maintained by Model and its Subsidiaries are reasonable and warranted, and not excessive, under the present circumstances.

4.6 Absence of Certain Changes or Events. Except (i) as disclosed in Section 4.6 of the Model Disclosure Schedule, (ii) for the Transactions or (iii) as permitted by this Agreement, since the Model Balance Sheet Date, Model and its Subsidiaries have carried on and operated their respective businesses in all material respects in the ordinary course of business consistent with past practice, and there has not occurred any:

(a) effect, event or change that would reasonably be expected to have a Material Adverse Effect with respect to Model;

(b) sale, transfer, distribution, abandonment or other disposal of, or mortgage, pledge or imposition of any encumbrance on any property (including real estate) or other assets of Model and its Subsidiaries that are material to Model and its Subsidiaries taken as a whole, except for (i) sales of inventory in the ordinary course of business consistent with past practice or (ii) dispositions of obsolete or worthless assets in the ordinary course of business consistent with past practice;

(c) declaration, setting aside or payment of any dividend or other distribution (whether in cash, stock or property) with respect to any class of capital stock of Model or any of its Subsidiaries (other than dividends or other distributions paid to Model by its Subsidiaries), or any repurchase, redemption or other acquisition by Model or any of its Subsidiaries of any capital stock or other securities of, or other ownership interest in, Model or any of its Subsidiaries;

(d) split, combination or reclassification of any capital stock of Model;

(e) change in financial or tax accounting methods, principles or practices by Model or its Subsidiaries, except insofar as may have been required by a change in GAAP or applicable Law;

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- (f) Tax election or the revocation or change to any Tax election or the settlement or compromise of any Tax liability by Model or any of its Subsidiaries;
- (g) granting by Model or any of its Subsidiaries to any director or employee of any award or bonus or other compensation, except to the extent accrued on the Model Balance Sheet;
- (h) granting by Model or any of its Subsidiaries to any employee of any increase in (or acceleration of vesting or payment of) severance or termination pay, except as required under any employment, severance or termination agreements set forth on Section 4.6 of the Model Disclosure Schedule;
- (i) entry by Model or any of its Subsidiaries into any (or amendment in any material respect of any existing) employment, severance or termination agreement with any employee of Model;
- (j) entry by Model or any of its Subsidiaries into any consulting agreement with any Person;
- (k) acceleration of the vesting of any option issued by Model or any of its Subsidiaries to acquire capital stock of Model or any of its Subsidiaries, except as contemplated in this Agreement;
- (l) capital expenditures by Model or any of its Subsidiaries, taken as a whole, in excess of 1,500,000 individually or \$1,500,000 in the aggregate;
- (m) establishment, amendment or termination of any collective bargaining agreement to which Model or any of its Subsidiaries is a party;
- (n) acceleration of accounts receivable other than in the ordinary course of business consistent with past practice;
- (o) general delay of payments by Model or any of its Subsidiaries to vendors or others to whom Model owes payments (except for disputed payments);
- (p) making of loans to any Persons other than in the ordinary course of business consistent with past practice or loans to any of its Subsidiaries;
- (q) settlement of any action, complaint, claim, petition, investigation, suit or other proceeding, whether civil or criminal, in law or in equity, before any arbitrator or Governmental Entity, to which Model or any of its Subsidiaries are a party or any of their respective properties is subject;
- (r) acceleration of the payment, right to payment or vesting under any benefit, retirement, profit sharing or deferred compensation plan or other compensation arrangement of Model or any of its Subsidiaries;

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- (s) incurrence of any Model Indebtedness (other than the Affiliate Debt) in an amount in excess of \$500,000 in the aggregate;
- (t) granting by Model or any of its Subsidiaries of any license or sublicense of any rights under or with respect to any Intellectual Property that is material to Model and its Subsidiaries;
- (u) establishment, amendment or contribution to any pension, retirement, profit sharing, stock bonus, multi-employer or other benefit plan covering any of the current or former employees, officers, directors or consultants of Model or any of its Subsidiaries, except as required by Law or pursuant to such benefit plan;
- (v) establishment of, or entering into, or financial commitment or contribution to, or amendment to the terms of, or termination of, any joint venture, partnership agreement or similar arrangement or any contract involving a sharing of profits, losses, business or opportunities with any other Person; or
- (w) any agreement or commitment by Model or any of its Subsidiaries to do any of the foregoing.

4.7 Legal Proceedings. Except as set forth in Section 4.7 of the Model Disclosure Schedule, there is (and in the past five years there has been) neither any pending or, to the Knowledge of Model, threatened, legal or administrative proceeding, claim (including any claim for indemnification under any agreement), suit or action by or against Model or any of its Subsidiaries, any of their respective assets or any of their respective officers or directors in their capacity as such nor any material Order imposed upon Model or any of its Subsidiaries by any Governmental Entity. Model has not received, as of the date hereof, any written notice of any claim that seeks to prevent the Transactions and, to the Knowledge of Model, no such claim has been threatened. No Governmental Entity has challenged in writing the right of Model and its Subsidiaries to conduct their business as currently conducted. Except as set forth in Section 4.7 of the Model Disclosure Schedule, all the matters listed on such schedule are covered by insurance, and could not be reasonably expected, individually or in the aggregate, to have a Material Adverse Effect with respect to Model.

4.8 Compliance with Applicable Law; Permits.

(a) Model and its Subsidiaries are (and during the past five years have been) in compliance in all material respects with all Laws applicable to Model or any of its Subsidiaries. Model and its Subsidiaries hold all material Permits necessary for the lawful conduct of their respective businesses. The operation of the businesses of Model and each of its Subsidiaries and their respective properties and assets are in compliance with all Permits in all material respects. No suspension, cancellation or termination of any such Permit is threatened or imminent other than expirations of Permits requiring renewal in the ordinary course of business and Model knows of no basis for such suspension, cancellation or termination nor basis upon which any expiring Permit will not be renewed. No approval is required under any Permit in connection with the Transactions and the Transactions will not violate any Permit or cause any Permit to terminate or give any Person the right to terminate such Permit.

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(b) Model and its Subsidiaries: (i) are in full compliance with the federal Food Drug and Cosmetic Act and all regulations issued thereunder, (ii) have no reasonable basis to believe that any ingredient used in their products is unsafe when used for its intended purpose, (iii) have conducted appropriate safety testing on each formulation that they produce to assure that such formulations are safe for their intended purpose, (iv) have not received any notification of an adverse event arising from the use of any of their products and/or formulations, (v) have not received any claims or notification of any personal injuries arising from the use of their products or formulations during the past five (5) years and (vi) do not use any ingredients in any of their products or formulations which would be considered unsafe by the Food and Drug Administration.

(c) To the Knowledge of Model, neither Model nor any of its Subsidiaries has mislabeled any of its products or mischaracterized the natural, organic or other certified nature thereof.

4.9 Tax Matters. Except as set forth on Section 4.9 of the Model Disclosure Schedule: (a) each of Model and its Subsidiaries has timely filed, or has caused to be timely filed on its behalf (taking into account any validly obtained extension of time within which to file), all Tax Returns and other Tax Returns required to be filed by it and all such filed Tax Returns are correct and complete in all respects; (b) all Taxes due and payable by Model or any of its Subsidiaries have been fully and timely paid; (c) neither Model nor any of its Subsidiaries currently is the beneficiary of any extension of time within which to file any Tax Return; (d) no claim has ever been made by an authority in a jurisdiction where Model or any of its Subsidiaries does not file a Tax Return that such entity is or may be subject to taxation by that jurisdiction; (e) there are no Liens for Taxes (other than Taxes not yet due and payable) upon any of the assets of Model or its Subsidiaries; (f) each of Model and its Subsidiaries has withheld and paid all Taxes required to have been withheld and paid in connection with any amounts paid or owing to any employee, independent contractor, creditor, stockholder, or other third party; (g) no foreign, federal, state, or local tax audits or administrative or judicial Tax proceedings are pending or being conducted with respect to Model or its Subsidiaries; (h) none of Model or its Subsidiaries has received from any foreign, federal, state, or local taxing authority (including jurisdictions where such entities have not filed Tax Returns) any (i) notice indicating an intent to open an audit or other review, (ii) request for information related to Tax matters, or (iii) notice of deficiency or proposed adjustment for any amount of Tax proposed, asserted, or assessed by any taxing authority against any of Model or its Subsidiaries; (i) Section 4.9 of the Model Disclosure Schedule lists any audit of Model and its Subsidiaries that has been conducted by a Taxing authority within the last three years.; (k) no deficiency or adjustment with respect to Taxes has been proposed, asserted or assessed against Model or any of its Subsidiaries; (j) adequate reserves for Taxes not yet due have been established on the Model Financial Statements in accordance with GAAP; (k) there are no outstanding waivers or agreements extending the statute of limitations for any period with respect to any Tax to which Model or any of its Subsidiaries may be subject; (l) neither Model nor any

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of its Subsidiaries is party to any agreement, understanding or arrangement (with any Person other than Model and/or any of its Subsidiaries) relating to allocating or sharing any Taxes, and; (m) neither Model nor any of its Subsidiaries is a party to any agreement, contract, arrangement or plan that has resulted or could result, separately or in the aggregate, in the payment of (i) any excess parachute payment within the meaning of Code Section 280G (or any corresponding provision of state, local or foreign Tax law) and (ii) any amount that will not be fully deductible as a result of Code Section 162(m) (or any corresponding provision of state, local or foreign Tax law); (r) neither Model nor any of its Subsidiaries has been a United States real property holding corporation within the meaning of Code Section 897(c)(2) during the applicable period specified in Code Section 897(c)(1)(A)(ii); (s) each of Model and its Subsidiaries has disclosed on its federal income Tax Returns all positions taken therein that could give rise to a substantial understatement of federal income Tax within the meaning of Code Section 6662; (t) none of Model or its Subsidiaries (A) has been a member of an affiliated group filing a consolidated federal income Tax Return (other than a group, the common parent of which was Model) or (B) has any liability for the Taxes of any Person (other than Model and its current Subsidiaries) under Treasury Regulation Section 1.1502-6 (or any similar provision of state, local, or foreign law), as a transferee or successor, by contract, or otherwise; (u) there are currently no limitations on the net operating losses, net capital losses, or credits of any of Model or its Subsidiaries, including under Sections 382, 383, 384 or 269 of the Code; (v) the unpaid Taxes of Model and its Subsidiaries (A) did not, as of the most recent fiscal month end, exceed the reserve for liability for Taxes (rather than any reserve for deferred Taxes established to reflect timing differences between book and Tax income) set forth on the face of the Model Balance Sheet (rather than in any notes thereto) and (B) do not exceed that reserve as adjusted for the passage of time through the Closing Date in accordance with the past custom and practice of the Model and its Subsidiaries in filing their Tax Returns; (w) since the date of the Model Balance Sheet, none of Model or its Subsidiaries has incurred any liability for Taxes arising from unusual gains or losses outside the ordinary course of business consistent with past custom and practice; (x) none of Model or its Subsidiaries has distributed stock of another Person, or has had its stock distributed by another Person, in a transaction that was purported or intended to be governed in whole or in part by Code Section 355.

4.10 Employee Benefits.

(a) Section 4.10(a) of the Model Disclosure Schedule is a true, complete and correct list of (a) each employee benefit plan, as defined in Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended (ERISA), (b) each employment, bonus, deferred or incentive compensation, profit sharing, retirement, stock option, stock purchase or other equity compensation, vacation, health, life or other insurance, Internal Revenue Code Section 125 cafeteria plan or flexible benefit arrangement, sick program or fringe benefit plan, arrangement, agreement or program and (c) any other employee plan or agreement, employment agreement, any severance plan, agreement, program or policy, or consulting agreement providing for on-going services that (i) benefits any current or former employee, officer, director, consultant or independent contractor and (ii) is sponsored,

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maintained or contributed to or required to be contributed to by Model or any ERISA Affiliate (each a Company Benefit Plan). Model has furnished or made available to E Com with respect to each Company Benefit Plan, if applicable, (a) each Company Benefit Plan, (b) Form 5500 as filed with the IRS for the three most recent years with any required audited financial statements, (c) the most recent summary plan description and any subsequent summaries of material modifications, (d) each trust agreement, plan contracts with service providers or insurers and insurance or group annuity contract providing benefits for participants or liability insurance for fiduciaries and other parties in interest or bonding, and (e) the most recent IRS determination letter for all plans qualified under Internal Revenue Code Section 401(a). ERISA Affiliate shall mean Model or any Subsidiary of Model, or any entity, which together with Model would be deemed a single employer within the meaning of Sections 414(b), (c) or (m) of the Internal Revenue Code (the Code) or Section 4001 of ERISA.

(b) Each Company Benefit Plan has been administered in all material respects in accordance with its terms. Model, its Subsidiaries and each Company Benefit Plan is in compliance in all material respects with the applicable provisions of ERISA, the Code and all other applicable Laws. No individual who has performed services for Model or any Subsidiary of Model has been improperly excluded from participation in any Company Benefit Plan. No Company Benefit Plan or any fiduciary of any such Company Benefit Plan has (i) engaged in any transaction prohibited by ERISA or the Code, (ii) breached any fiduciary duty owed by it with respect to the Plans, or (iii) engaged in any transaction as a result of which Model or any Subsidiary of Model would be subject to any liability pursuant to Sections 406 or 409 of ERISA or to either a civil penalty assessed pursuant to Section 502(i) or Section 502(l) of ERISA or a Tax imposed pursuant to Section 4975 of the Code. Model and each ERISA Affiliate has complied in all material respects with the continuation coverage requirements of Section 4980B of the Code and Sections 601-608 of ERISA applicable to Model or such ERISA Affiliate. No actions, audits, investigations, suits or claims with respect to a Company Benefit Plan (other than routine claims for benefits) are pending or, to the Knowledge of Model, threatened, which could result in or subject Model or any Subsidiary of Model to any liability.

(c) Each Company Benefit Plan which is intended to be qualified within the meaning of Section 401(a) of the Code has received from the Internal Revenue Service (the IRS) a favorable determination letter that remains in effect on the date hereof and no event has occurred since the date of the most recent determination letter or application therefor relating to any such Company Benefit Plan that is reasonably likely to adversely affect the qualification of such Company Benefit Plan.

(d) All contributions (including all employer contributions and employee salary reduction contributions), premiums and benefit payments required by and due from Model and any Subsidiary of Model under or in connection with the terms of each Company Benefit Plan have been made within the time periods prescribed by the Company Benefit Plan, ERISA and the Code.

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(e) No Company Benefit Plan is subject to Title IV of ERISA, the minimum funding requirements of Section 302 of ERISA or Section 412 of the Code nor provides for medical or life insurance benefits to retired or former employees of Model or any Subsidiary of Model (other than as required under Code §4980B, ERISA or similar state law). Neither Model nor any ERISA Affiliate is a participating or contributing employer in any multiemployer plan (as defined in Section 3(37) of ERISA) subject to Title IV of ERISA with respect to employees of Model or any Subsidiary of Model and neither Model nor any of its ERISA Affiliates has any outstanding withdrawal liability in connection with a complete or partial withdrawal from any multiemployer plan.

(f) Neither the execution and delivery of this Agreement nor the consummation of the Transactions will, either alone or in combination with any other event, (i) result in any payment becoming due, or increase the amount of compensation due, to any current or former employee or director of Model or any Subsidiary of Model, (ii) increase any benefits payable under any Company Benefit Plan, or (iii) result in any acceleration of the time of payment or vesting of any such compensation or benefits. Further, neither Model nor any Subsidiary of Model has announced any type of plan or binding commitment to create any additional Company Benefit Plan, to enter into any agreement with any current or former employee or director, or to amend or modify any existing Company Benefit Plan or agreement with any current or former employee or director.

4.11 Labor Matters.

(a) Except as set forth in Section 4.11(a) of the Model Disclosure Schedule, neither Model nor any of its Subsidiaries is a party to or otherwise bound by any labor or collective bargaining agreement, and there are no labor or collective bargaining agreements that pertain to their respective employees. Except as set forth in Section 4.11(a) of the Model Disclosure Schedule, no labor organization or group of employees of Model or any of its Subsidiaries has made a pending demand for recognition, and, within the preceding six years, there has been no representation or certification proceeding, or petition seeking a representation proceeding, pending or, to the Knowledge of Model, threatened to be brought or filed with the National Labor Relations Board or any other labor relations tribunal or Governmental Entity. Except as set forth in Section 4.11(a) of the Model Disclosure Schedule, within the preceding six years, there has been no organizing activity involving Model or any of its Subsidiaries pending or, to the Knowledge of Model, threatened by any labor organization or group of employees of Model or any of its Subsidiaries.

(b) There are no pending or, to the Knowledge of Model, threatened investigations of or relating to Model or any of its Subsidiaries by any Governmental Entity responsible for the enforcement of labor or employment Laws.

(c) There has never been any strike, work stoppage, slowdown, picketing, lockout, walkout, other job action, arbitration, grievance, unfair labor practice charge or complaint or other labor dispute involving Model or any of its Subsidiaries or to the

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Knowledge of Model, threatened against Model or any of its Subsidiaries, and to the Knowledge of Model, there are no facts or circumstances which could form the basis for any of the foregoing.

(d) Neither Model nor any of its Subsidiaries has implemented any plant closing or mass layoff of employees that would reasonably be expected to require notification under the Worker Adjustment and Retraining Notification Act (as amended, WARN) or any similar state or local Law, no such plant closing or mass layoff will be implemented before the Closing Date without advance notification to and approval of Model, and there has been no employment loss, as defined by WARN, within the ninety (90) days prior to the Closing Date.

(e) Model and each of its Subsidiaries are in compliance with all Laws relating to the employment of labor, including all such Laws relating to wages, hours, collective bargaining, discrimination, civil rights, occupational safety and health, workers compensation and the collection and payment of withholding and/or social security Taxes and other Taxes. There are no actions against Model or any of its Subsidiaries pending or, to the Knowledge of Model, threatened to be brought or filed with any public authority, Governmental Entity, arbitrator or court based on, arising out of, in connection with, or otherwise relating to the employment or termination of employment or services by Model or any of its Subsidiaries of any individual, including but not limited to the Civil Rights laws, Americans with Disabilities Act, Age Discrimination in Employment Act (as amended by the Older Workers Benefit Protection Act), Pregnancy Discrimination Act, Equal Pay Act, Fair Labor Standards Act, WARN, and Family and Medical Leave Act, and, to the Knowledge of Model, there are no facts or circumstances which could form the basis for any of the foregoing.

4.12 Environmental Matters.

(a) For purposes of this Section 4.12, the following definitions will apply:

(i) Environmental Claims means any complaint, summons, citation, notice, directive, order, claim, litigation, investigation, notice of violation, judicial or administrative proceeding, judgment, letter or other communication from any Governmental Entity, department, bureau, office or other authority, or any third party involving violations of Environmental Laws from (i) any assets, properties or businesses of Model, any of its Subsidiaries or their respective predecessors in interest or (ii) from or onto any facilities which received Hazardous Materials generated by Model, any of its Subsidiaries or their respective predecessors in interest.

(ii) Environmental Liabilities means any monetary obligations, losses, liabilities (including strict liability), damages, punitive damages, consequential damages, treble damages, costs and expenses (including all reasonable out-of-pocket fees, disbursements and expenses of counsel, out-of-pocket expert and consulting fees and out-of-pocket costs for

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environmental site assessments, remedial investigation and feasibility studies), fines, penalties, sanctions and interest to the extent any of the foregoing are incurred as a result of any Environmental Claim filed by any Governmental Entity or any third party which relate to any violations of Environmental Laws, Remedial Actions, Releases or threatened Releases of Hazardous Materials from or onto (i) any property presently or formerly owned, leased or operated by Model, any of its Subsidiaries or their respective predecessors in interest, or (ii) any facility which received Hazardous Materials generated by Model, any of its Subsidiaries or their respective predecessors in interest.

(b) Except as would not likely result in Model or any Subsidiary of Model incurring material Environmental Liabilities:

(i) The operations of Model and its Subsidiaries are in compliance with Environmental Laws in all material respects;

(ii) Model and its Subsidiaries have obtained and are in material compliance with all material and necessary permits or authorizations that are required under Environmental Laws to operate the facilities, assets and business of Model;

(iii) There has been no Release by Model or any of its Subsidiaries or, to the Knowledge of Model, by any other Person at any of the properties currently owned, leased or operated by Model or any of its Subsidiaries, or, to the Knowledge of Model, at any property formerly owned, leased or operated by Model or any of its Subsidiaries or at any disposal or treatment facility which received Hazardous Materials generated by Model, any of its Subsidiaries nor any of their respective predecessors in interest which is reasonably likely to result in material Environmental Liabilities;

(iv) No pending or unresolved Environmental Claims have been asserted against Model or any of its Subsidiaries or, to the Knowledge of Model, any predecessor in interest of Model or any of its Subsidiaries, nor does Model have notice of any threatened or pending Environmental Claim against Model, any of its Subsidiaries or any such predecessor in interest regarding any facilities that may have received Hazardous Materials generated by Model, any of its Subsidiaries nor any of their respective predecessors in interest which is reasonably likely to result in material Environmental Liabilities;

(v) Except for Environmental Claims that have been resolved and satisfied solely by the payment of money which has been paid on or before the Model Balance Sheet Date or is reflected as a liability on the Model Balance Sheet, neither

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Model, any of its Subsidiaries nor any of their respective predecessors in interest, has transported or arranged for the treatment, storage or disposal of any Hazardous Materials to any off-site location that has resulted in an Environmental Claim or is reasonably likely to lead to any Environmental Claim to Model or any of its Subsidiaries under applicable Environmental Laws.

(c) Model has made available to E Com true and complete copies of all material environmental reports, studies, and investigations regarding any material Environmental Liabilities of Model and its Subsidiaries and of any material environmental conditions at any properties owned or operated by Model, which are in the possession of Model.

4.13 Insurance.

(a) Section 4.13(a) of the Model Disclosure Schedule sets forth a list of all current insurance policies maintained by Model and its Subsidiaries. All such policies are in full force and effect, and neither Model nor any of its Subsidiaries is in default with respect to their material obligations under any such policy so as to cause a loss of coverage. Neither Model nor any of its Subsidiaries has received notice of cancellation or termination in respect of any such policy and knows of no basis for such cancellation, termination or loss of coverage. Such policies provide for insurance of Model and its Subsidiaries which is adequate and customary for businesses of similar type to Model and its Subsidiaries.

(b) There have been no gaps in coverage under such insurance policies of Model or its Subsidiaries as in effect from time to time during their existence. As of and after the Closing, Model and each of its Subsidiaries will have the right to continued coverage for occurrences prior to the Closing under such policies. The current and historical limits of liability under such policies have not been exhausted or impaired. All losses that have been incurred by Model and its Subsidiaries that are covered by such policies have been properly reported to their respective insurance carriers, and no reservation of rights letters have been issued by such carriers. Except as set forth on Section 4.13(a) of the Model Disclosure Schedule, there are no pending or potential premium audits or adjustments relating to the casualty insurance policies that currently cover Model or any of its Subsidiaries that are not reserved on the Model Balance Sheet.

4.14 Finders or Brokers. Except for Wachovia Capital Markets, LLC, no broker, investment banker, financial advisor or other Person is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with the Transactions based upon arrangements made by or on behalf of Model, any of its Subsidiaries or any of its Affiliates.

4.15 Contracts.

(a) Section 4.15(a) of the Model Disclosure Schedule contains a complete and correct list of the following contracts and agreements (whether written or oral) to which Model or any of its Subsidiaries is a party (collectively, the Model Material

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Contracts): (i) all contracts (other than relating to purchases and sales of inventory in the ordinary course of business) which involve or are reasonably expected to involve aggregate payments or expenditures by or to Model or any of its Subsidiaries during the fiscal year ending October 31, 2008 in excess of \$250,000; (ii) all Model Indebtedness (other than guarantees by way of endorsement or negotiable instruments in the ordinary course of business); (iii) any contracts containing covenants not to compete (A) binding on Model or any of its Subsidiaries, (B) restricting other Persons for the benefit of Model or any of its Subsidiaries or (C) which otherwise restrict competition granted by Model or any of its Subsidiaries in favor of a third Person; (iv) contracts under which Model or any of its Subsidiaries is obligated to indemnify any Person other than agreements entered into in the ordinary course of business; (v) contracts to loan money or extend credit to any other Person, other than product warranties in the ordinary course of business; and (vi) joint venture, partnership agreements or similar arrangements or contracts involving a sharing of profits, losses, business or opportunities with any other Person.

(b) With respect to the Model Material Contracts, (i) such Model Material Contracts are in full force and effect and are valid, binding and enforceable against Model or its Subsidiaries, as applicable, and, to the Knowledge of Model, each other party thereto, and (ii) Model and its Subsidiaries, and, to the Knowledge of Model, each other party thereto, have complied in all material respects with all respective covenants and provisions of the Model Material Contracts. Except as set forth on Section 4.15(b) of the Model Disclosure Schedule, none of the rights of Model or any of its Subsidiaries under any Model Material Contract will be subject to termination or modification (nor will any Person have the right to accelerate the performance of Model or such Subsidiary of Model under any Model Material Contract), and no notice to or consent or approval of any other Person is required under any Model Material Contract, as a result of the consummation of the Transactions.

(c) Except to the extent set forth in Section 4.15(c) of the Model Disclosure Schedule, there are no transactions, agreements, arrangements or understandings between Model or any of its Subsidiaries, on the one hand, and Model's directors, officers, affiliates (other than wholly-owned Subsidiaries of Model) or other Persons, on the other hand.

(d) Model and its Subsidiaries have good title or valid leasehold interests in all tangible assets that are material to the operation of their respective businesses.

(e) Except as set forth in Section 4.15(e) of the Model Disclosure Schedule, there are neither any contractual nor, to the Knowledge of Model, any legal, regulatory or other restrictions that prohibit Model or any of its Subsidiaries from transferring cash (or cash equivalents) between accounts outside of and inside the United States or that limit Model's free use of such cash.

(f) Section 4.15(f) of the Model Disclosure Schedule sets forth an itemized list, prepared in good faith, of Model's expenses incurred through October 31, 2007, and the total amount of additional expenses that Model estimates, as of the date hereof,

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to be incurred by it in connection with the Transactions contemplated by this Agreement, including, without limitation, the fees and expenses of Model's financial advisors and outside counsel and accountants.

4.16 Owned Real and Personal Property; Encumbrances.

(a) Neither Model nor any of its Subsidiaries owns any real property and neither Model nor any of its Subsidiaries or any of their respective predecessors has ever owned any real property.

(b) Except for Model Permitted Encumbrances, Model or its Subsidiaries, as the case may be, has good title to all of the material tangible personal property reflected as being owned by it on the Model Balance Sheet (except for personal property sold or otherwise disposed of since the Model Balance Sheet Date in the ordinary course of business consistent with past practices), which personal property, together with personal property leased by Model or its Subsidiaries described on Section 4.16 of the Model Disclosure Schedule, constitutes all personal property necessary for conducting the business of Model and its Subsidiaries as presently conducted. The personal property owned or leased by Model and its Subsidiaries, taken as a whole, is adequate and in a condition sufficient to permit Model and its Subsidiaries to conduct their respective businesses in all material respects in the same manner as it is being conducted as of the date of this Agreement, subject to ordinary wear and tear and routine maintenance. Model Permitted Encumbrances means (i) statutory liens for current Taxes or assessments not yet due or delinquent or the validity of which are being contested in good faith by appropriate proceedings (a list of all such proceedings as of the date of this Agreement being included on Section 4.9 of the Model Disclosure Schedule) and (ii) mechanics', carriers', workers', repairmen's and other similar liens arising or incurred in the ordinary course of business with respect to charges not yet due and payable.

4.17 Leased Real and Personal Property. Section 4.17 of the Model Disclosure Schedule sets forth a true and complete list of each lease, sublease or license (each a Model Material Lease) under which Model or any of its Subsidiaries is a lessee, lessor, sublessee, sublessor, licensee or licensor which (a) is a lease of real property or any interest in real property, or (b) is a lease of personal property which provides for payments of more than \$100,000 per year, has a term exceeding one year and may not be canceled upon 90 or fewer days' notice without any liability, penalty or premium (other than a nominal cancellation fee or charge). With respect to the Model Material Leases, (i) each Model Material Lease is in full force and effect and is valid, binding and enforceable in accordance with its terms, (ii) all accrued and currently payable rents and other payments required by such Model Material Lease have been paid and (iii) Model and its Subsidiaries, and, to Model's Knowledge, each other party thereto have complied in all material respects with all respective covenants and provisions of the Model Material Lease. Model or one of its Subsidiaries, as applicable, enjoys peaceful and undisturbed possession under each Model Material Lease to which it is a lessee, sublessee or licensee and there is not, with respect to any Model Material Lease, any event of default, or event which with notice or

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lapse of time or both would constitute an event of default, existing on the part of Model or such Subsidiary or, to the Knowledge of Model, on the part of any other party thereto. Except as set forth on Section 4.19 of the Model Disclosure Schedule, none of the rights of Model or any of its Subsidiaries under any Model Material Lease will be subject to termination or modification (nor will any Person have the right to accelerate the performance of Model or such Subsidiary under any Model Material Lease), and no notice to or consent or approval of any other Person is required under any Model Material Lease as a result of the consummation of the Transactions.

4.18 Intellectual Property.

(a) Section 4.18(a) of the Model Disclosure Schedule contains a complete and accurate list of all (i) patented or registered Intellectual Property owned or, to the Knowledge of Model, used by Model and its Subsidiaries, (ii) pending patent applications and applications for other registrations of Intellectual Property filed by or on behalf of Model or any of its Subsidiaries, and (iii) to the Knowledge of Model, material unregistered Intellectual Property owned or used by Model and its Subsidiaries, other than shrink-wrapped, click-wrapped or off-the-shelf software licenses licensed by Model and its Subsidiaries. All patents, patent applications, registered trademarks, trademark applications, trade names, registered service marks, service mark applications, logos, registered copyrights, copyright applications and domain names set forth on Section 4.18(a) of the Model Disclosure Schedule have been duly registered in, filed in, or issued by the United States Patent and Trademark Office, United States Register of Copyrights, Network Solutions, Inc. (or other authorized domain name registry) or the corresponding offices of any other country, state, or other jurisdiction to the extent set forth on Section 4.18(a) of the Model Disclosure Schedule, and have been properly maintained or renewed in accordance with all applicable provisions of Law and administrative regulations in the United States and in each such other country, state, or other jurisdiction.

(b) Section 4.18(b) of the Model Disclosure Schedule contains a complete and accurate list of all agreements, licenses, royalty agreements, and other rights granted by Model and its Subsidiaries to any other Person with respect to any Intellectual Property set forth on Section 4.18(a) of the Model Disclosure Schedule and all licenses, agreements, and other rights granted by any third Person to Model and its Subsidiaries with respect to any Intellectual Property set forth on Section 4.18(a) of the Model Disclosure Schedule (other than shrink-wrapped or off-the-shelf software licenses licensed by Model and its Subsidiaries), in each case identifying the subject Intellectual Property. Except as set forth on Section 4.18(b) of the Model Disclosure Schedule, Model and its Subsidiaries have the sole and exclusive right to use the Intellectual Property and there are no licenses, sublicenses or agreements relating to the use by any other Person of any of such Intellectual Property now in effect. There is no outstanding and, to the Knowledge of Model, no threatened disputes or disagreements with respect to any such agreement, licenses, royalty agreements or other rights.

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(c) The Intellectual Property set forth on Section 4.18(a) of the Model Disclosure Schedule comprises all Intellectual Property necessary for the operation of the respective businesses of Model and its Subsidiaries as they are currently conducted. Model and its Subsidiaries, as applicable, own all right, title and interest in and to each item of Intellectual Property, free and clear of all encumbrances except for Model Permitted Encumbrances, and have the right to use without payment to any third party all of their respective Intellectual Property. Model and its Subsidiaries are not currently using and it will not be necessary for Model and its Subsidiaries to use any Intellectual Property of any of its present or former employees developed, invented or made prior to their employment by Model and its Subsidiaries except for any such Intellectual Property that have previously been assigned to Model and its Subsidiaries. No present or former employee of Model or any of its Subsidiaries and, except as set forth on Section 4.18(b) of the Model Disclosure Schedule, no other Person owns or has any proprietary, financial or other interest, direct or indirect, in whole or in part, in any Intellectual Property which Model or any of its Subsidiaries owns or uses in the conduct of their respective businesses as now or heretofore conducted. None of the management and salaried employees of Model and its Subsidiaries have signed agreements relating to noncompetition, nonsolicitation, confidentiality and/or assignment of inventions. Model and its Subsidiaries have taken all reasonable and appropriate steps to protect their trade secrets.

(d) No loss or expiration of any Intellectual Property or related group of Intellectual Property owned or used by Model and its Subsidiaries has occurred which has had or would reasonably be expected to have a Material Adverse Effect with respect to Model, and no loss or expiration of any such Intellectual Property is threatened in writing, or, to Model's Knowledge, pending or reasonably foreseeable.

(e) (i) There have been no written claims made against Model or any of its Subsidiaries asserting the invalidity, misuse or unenforceability of any of the Intellectual Property owned or used by Model or any of its Subsidiaries, (ii) Model and its Subsidiaries have not received any written notices of any infringement or misappropriation by, or conflict with, any third party with respect to any Intellectual Property (including any demand or request that Model or any of its Subsidiaries licenses any rights from a third party), (iii) the conduct of the business of Model and its Subsidiaries has not infringed, misappropriated or conflicted with and does not infringe, misappropriate or conflict with any Intellectual Property of other Persons and (iv) to the Knowledge of Model, no Person has infringed upon or is currently infringing upon any material Intellectual Property of Model and its Subsidiaries. The transactions contemplated by this Agreement will not materially adversely effect the right, title or interest in and to the Intellectual Property of Model and its Subsidiaries listed on Section 4.18(a) of the Model Disclosure Schedule and all of such Intellectual Property shall be owned or available for use by Model and its Subsidiaries on substantially identical terms and conditions immediately after the Closing as currently pertains thereto.

4.19 Corporate Documents: Books and Records. The books, records and accounts of Model and its Subsidiaries, including all minute books of Model and its Subsidiaries, reflect in all material respects, the actions, meetings, transactions and the assets and

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liabilities of Model and its Subsidiaries. Model and each of its Subsidiaries have not engaged in any material transaction with respect to their respective businesses, maintained any bank account for their respective businesses, or used any of the funds of Model or any of its Subsidiaries in the conduct of their respective businesses, except for transactions, bank accounts and funds which have been and are reflected in the books and records of Model and each of its Subsidiaries.

4.20 Bank Accounts. Section 4.20 of the Model Disclosure Schedule sets forth each of the bank accounts and the employees of Model and each of its Subsidiaries that are authorized signatories with respect to such accounts.

4.21 Related Person Transactions. Except as set forth in the footnotes to the Model Financial Statements and Section 4.21 of the Model Disclosure Schedules and for the Affiliate Consignment and issuance of Affiliate Debt, during the period from November 1, 2003 through the date hereof (or, at the Closing, through the Closing Date), there have been no transactions, and there are no currently proposed transactions, in which Model or any of its Subsidiaries was or is to be a participant in which any of the Persons described in Item 404 of SEC Regulation S-K had or will have a direct or indirect material interest and which would be required to be disclosed in Item 404 of SEC Regulation S-K without giving effect to the amount involved in such transaction.

4.22 Disclosure. This Agreement (including the Model Disclosure Schedules) does not contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements contained herein and therein, in light of the circumstances under which such statements were made, not misleading.

ARTICLE 5 - ADDITIONAL COVENANTS AND AGREEMENTS

5.1 Conduct of Business.

(a) Except (i) as permitted or contemplated by this Agreement, (ii) as required by applicable Law, or (iii) in the case of Model or its Subsidiaries, tenant improvements to new facilities and costs relating to holding over in existing facilities pending availability of new facilities or the Affiliate Consignment, during the period from the date of this Agreement until the earlier of the Termination Date or the Closing Date, unless E Com or Acquisition Sub, on the one hand, and Model, on the other hand, otherwise consent in writing, each party hereto shall, and shall cause each of its Subsidiaries to, (x) conduct its business in all material respects in the ordinary course consistent with past practice, and (y) preserve its current relationships with its material customers, vendors, suppliers and other Persons with which they have business relationships.

(b) During the period from the date of this Agreement until the earlier of the Termination Date or the Closing Date, except as expressly contemplated or permitted by this Agreement or as required by applicable Law, and except as may be agreed in writing by E Com or Acquisition Sub, on the one hand, and Model, on the other hand, each party shall not, and shall not permit any of its

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Subsidiaries to, take any action or agree, in writing or otherwise, to take any action which would cause any of the representations or warranties of such party set forth in this Agreement (A) that are qualified as to materiality or Material Adverse Effect to be untrue and (B) that are not so qualified to be untrue in any material respect. In addition, each party shall not, and shall not permit any of its Subsidiaries to, acquire or agree to acquire by merging or consolidating with, or by purchasing a substantial portion of the assets of or equity in, or by any other manner, any Person or portion thereof, or otherwise acquire or agree to acquire any assets of any Person outside the ordinary course of business in accordance with past practice, except as part of a transaction permitted by Section 5.3.

(c) During the period from the date of this Agreement until the earlier of the Termination Date or the Closing Date, each party shall give the other party notice of any effect, event or change that would reasonably be expected to have a Material Adverse Effect with respect to the notifying party.

5.2 Reasonable Best Efforts. Subject to the terms and conditions of this Agreement and subject to the provisions of Section 5.3 below, Model and E Com shall each cooperate with the other and use (and shall cause their respective Subsidiaries to use) their respective reasonable best efforts to (a) promptly (i) take or cause to be taken all actions, and do or cause to be done all things, necessary, proper or advisable under this Agreement and applicable Laws, to consummate the Transactions as soon as practicable, including preparing and filing promptly and fully all documentation to effect all necessary filings, notices, petitions, statements, registrations, submissions of information, applications and other documents (except that the Certificates of Merger shall be filed contemporaneously with the Closing), and (ii) obtain all approvals, consents, registrations, permits, authorizations and other confirmations from any Governmental Entity or third Person necessary, proper or advisable to consummate the Transactions and (b) take all action necessary to ensure that no state takeover statute or similar Law is or becomes applicable to any of the Transactions and, if any state takeover statute or similar Law becomes applicable to any of the Transactions, take all action necessary to ensure that the Transactions may be consummated as promptly as practicable on the terms contemplated by this Agreement and otherwise minimize the effect of such Law on the Transactions.

5.3 Other Offers: Fiduciary Obligations. (a) Unless and until this Agreement shall have been terminated in accordance with its terms, neither E Com nor its Subsidiaries shall, through any officer, manager, director, member, employee, representative or agent of E Com or any of its Subsidiaries solicit or take other action to facilitate any inquiries or the making of any proposal that constitutes or may reasonably be expected to lead to an Acquisition Proposal, participate in any way in any discussions or negotiations relating thereto or in furtherance thereof or accept any Acquisition Proposal, or enter into any agreement, arrangement or understanding requiring E Com to abandon, terminate or fail to consummate the Transactions; provided, however, that nothing contained in this Section 5.3 shall prohibit E Com, or its Board of Directors, from making any disclosure to its shareholders that in the judgment of its Board of Directors is in accordance with, and based upon the advice of outside counsel, is required under applicable Law or in

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connection with SEC filings or filings under the HSR Act or from issuing press releases in accordance with Section 5.4. For purposes of this Agreement, Acquisition Proposal means any offer to acquire all or any substantial part of the business and properties or capital stock or membership interest of E Com or any of its Subsidiaries, whether by merger, consolidation, sale of assets, tender offer, or similar transaction or series of transactions involving E Com or any of its Subsidiaries. E Com hereby represents that neither it nor any of its Subsidiaries is engaged in discussions or negotiations with any Person other than Model with respect to any Acquisition Proposal.

(b) Notwithstanding Section 5.3(a), the Board of Directors of E Com, in the exercise of and as required by its fiduciary duties, as determined in good faith by the Board of Directors of E Com, may (i) furnish information (including, without limitation, confidential information) concerning E Com to a third Person who makes an unsolicited request for such information for the purpose of making an Acquisition Proposal, and (ii) engage in discussions or negotiations with a third party who submits in writing an interest in making an Acquisition Proposal that the Board of Directors of E Com believes is reasonably capable of being consummated, provided, in the case of clause (i) or (ii) hereof, that Model shall have been promptly notified in writing of such request for information or Acquisition Proposal, including the identity of the offeror or the party making such offer or proposal and the principal financial terms and conditions of such offer or proposal, as the case may be, and shall be kept reasonably informed as to the status of any discussions or negotiations referred to in clause (ii) above, so long as Model shall have agreed to keep such information confidential on terms reasonably acceptable to E Com.

(c) Upon compliance with the foregoing, (i) the Special Committee and/or the Board shall be entitled to withdraw or modify their respective recommendations under Section 3.3 following receipt of a Superior Proposal and approve and recommend to the shareholders of E Com such Superior Proposal, (ii) the Board of Directors of E Com shall be entitled to postpone the Shareholders Meeting for a total period of not more than thirty (30) days to consider any Acquisition Proposal, notice of which shall have been provided to Model pursuant to Section 5.3(b), that the Special Committee shall reasonably determine may represent a Superior Proposal, and (iii) E Com shall be entitled to enter into an agreement with such third Person concerning such Superior Proposal on terms no less favorable to E Com than those set forth in the notice to Model pursuant to Section 5.3(b). A Superior Proposal is an Acquisition Proposal that the Board of Directors reasonably believes (A) is likely to be superior from a financial point of view to the transactions contemplated by this Agreement and (B) is capable of being consummated within a reasonable period of time.

5.4 Public Announcements. The initial press release with respect to the execution of this Agreement shall be the joint press release heretofore agreed upon by Model and E Com. E Com shall also file a Current Report on Form 8-K reporting the entering into of this Agreement and filing a copy of this Agreement and such joint press release as exhibits thereto. Thereafter, neither Model nor E Com shall, without the prior consent of the other party (which consent shall not be unreasonably withheld or delayed), issue or cause

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the publication of any press release or other public announcement with respect to this Agreement or the Transactions, except for any such press release or public announcement as may be required by Law as determined in the good faith judgment of the party proposing to make such release or announcement, upon advice of legal counsel, provided that no such release or announcement shall be made before reasonable (in the circumstances) advance notice of the same has been given to the other party.

5.5 Access. Upon reasonable notice and subject to applicable Laws relating to the exchange of information, Model shall, and shall cause each of its Subsidiaries to, afford to the officers, employees and other representatives of E Com, during the period prior to the Effective Time, access to its properties, books, contracts, commitments and records, and to its officers, employees and other representatives and, during such period, Model shall, and shall cause its Subsidiaries to, make available to E Com all other information concerning its business, properties and personnel as E Com may reasonably request. Until the Effective Time, the information provided will be used solely in connection with the Transactions.

5.6 Notification of Certain Matters. Model shall give prompt notice to E Com, and E Com shall give prompt notice to Model, of (i) any notice or other communication received by such party from any Governmental Entity in connection with the Transactions or from any Person alleging that the consent of such Person is or may be required in connection with the Transactions, and (ii) any actions, suits, claims, investigations or proceedings commenced or, to such party's Knowledge, threatened against, relating to or involving or otherwise affecting such party or any of its Subsidiaries which relate to the Transactions.

5.7 Director and Officer Indemnification. From and after the Closing Date and for a period of six (6) years thereafter, the Surviving Entity shall assume all obligations of Model, and cause the Surviving Entity's Subsidiaries to maintain in effect all such obligations owed by them, to each individual who at the Effective Time is, or any time prior to the Effective Time was, a director, officer or employee of Model or any of its Subsidiaries (the Indemnitees) in respect of indemnification and exculpation from liabilities for acts or omissions occurring at or prior to the Effective Time to the extent provided in the Model Charter Documents (or predecessor documents) and the organizational documents of such Subsidiaries as currently in effect and the BCL and the DLLCA as in effect as of the Effective Time. Without limiting the foregoing, E Com, from and after the Effective Time, shall cause the certificate of formation and limited liability company agreement of the Surviving Entity and its Subsidiaries to contain provisions no less favorable to the Indemnitees with respect to limitation of liabilities of directors, officers and managers and indemnification than are set forth as of the date of this Agreement in the Model Charter Documents, which provisions shall not be amended, repealed or otherwise modified in a manner that would adversely affect the rights thereunder of the Indemnitees.

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5.8 Delivery of Financial Information. From the date hereof to the Closing Date, Model shall deliver to E Com: (i) as soon as available, but in no event later than thirty (30) days after the end of each month subsequent to the date hereof consolidated financial statements of Model prepared in accordance with GAAP and consistent with those used in the preparation of the Model Financial Statements; and (ii) such other financial and operating information regarding the business of Model and its Subsidiaries as E Com reasonably requests, including, without limitation, monthly capital expenditure reports. Such financial statements have been and will be prepared on a basis consistent from period to period.

5.9 Subsequent Transactions with Model Shareholders. The Model Shareholders agree not to effect a merger, consolidation, combination or other transaction resulting in the acquisition by the Model Shareholders of all of the outstanding shares of E Com Common Stock, unless they collectively shall control ninety percent (90%) or more of the issued and outstanding shares of E Com Common Stock prior to such transaction.

5.10 Tax Matters.

(a) Regardless of the accuracy of the representations and warranties in Section 4.9 of this Agreement, the Model Shareholders shall be responsible for and shall indemnify and hold E Com and its Affiliates harmless against (i) all Taxes (or the non-payment thereof) of Model and its Subsidiaries for all taxable periods ending on or before the Closing Date and the portion through the end of the Closing Date for any taxable period that includes (but does not end on) the Closing Date (Pre-Closing Tax Period), (ii) all Taxes of any member of an affiliated, consolidated, combined or unitary group of which Model or any of its Subsidiaries (or any predecessor of any of the foregoing) is or was a member on or prior to the Closing Date, pursuant to Treasury Regulation section 1.1502-6 or any analogous or similar state, local, or foreign law or regulation, (iii) any and all Taxes of any person imposed on any of Model or its Subsidiaries as a transferee or successor, by contract or pursuant to any law, rule, or regulation, which Taxes relate to an event or transaction occurring before the Closing Date provided, however, that in the case of clauses (i), (ii) and (iii) above, Model Shareholders shall be liable only to the extent that such Taxes are in excess of the amount, if any, reserved for such Taxes (excluding any reserve for deferred Taxes established to reflect timing differences between book and Tax income) on the face of the Model Balance Sheet (rather than in any notes thereto), as such reserve is adjusted for the passage of time through the Closing Date in accordance with past custom and practice of Model and its Subsidiaries in filing their Tax Returns, but excluding any income Taxes resulting from unusual gains or losses outside of the ordinary course of business occurring after the date of this Agreement and on or prior to the Closing Date and, provided further, for purposes of the Tax indemnification provided by this Section 5.10, the Merger contemplated by this Agreement shall be deemed to occur after the Pre-Closing Tax Period.

In the case of Taxes that are payable with respect to any taxable period that begins before the Closing Date but ends after the Closing Date (the Straddle Period), the portion of any Taxes based on or measured by income or receipts of Model or its Subsidiaries for the

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Pre-Closing Tax Period shall be determined based on an interim closing of the books as of the close of business on the Closing Date (and for such purpose, the taxable period for any partnership or other pass-through entity in which any of Model and/or its Subsidiaries holds a beneficial interest shall be deemed to terminate at such time); and the amount of all other Taxes for a Straddle Period that relates to the Pre-Closing Tax Period shall be deemed to be the amount of such Tax for the entire Straddle Period multiplied by a fraction the numerator of which is the number of days in the period ending on the Closing Date and the denominator of which is the number of days in the entire Straddle Period.

Payment by the indemnifying party of any amount due under this Section 5.10(a) shall be made within ten days following written notice by the indemnified party that payment of such amounts to the appropriate taxing authority is due, provided, that the indemnifying party shall not be required to make any payment earlier than two days before it is due to the appropriate taxing authority.

(b) E Com shall prepare and timely file, or cause to be prepared and timely filed, all Pre-Closing Period Returns due after the Closing Date and E Com shall prepare and timely file, or cause to be prepared and timely filed, all Straddle Period Returns required to be filed after the Closing Date; provided, however, that in the case of any such Tax Returns, the Shareholder Representative shall have the right (prior to filing) to review and comment on any such Tax Return and E Com shall consider such comments in good faith. All such Tax Returns shall be true and correct in all material respects.

(c) In the case of any Pre-Closing Period Return, E Com shall provide the Shareholder Representative: (i) a copy of such Tax Return as filed or to be filed; (ii) a schedule computing the Tax shown as due on any such Pre-Closing Period Return or the portion of the Tax shown as due on any such Straddle Period Return which relates to the portion of the period covered by such Straddle Return ending on the Closing Date (the Pre-Closing Tax). Within the time period prescribed in Section 5.10(a), Model Shareholders shall indemnify E Com or its Affiliates against any Pre-Closing Tax that is due and payable, to the extent in excess of the amount of Taxes reserved (excluding any reserve for deferred Taxes established to reflect timing differences between book and Tax income) on the face of the Model Balance Sheet (rather than in any notes thereto).

(d) E Com and the Model Shareholders shall reasonably cooperate, and shall cause their respective Affiliates, agents, auditors, representatives, officers and employees to reasonably cooperate, in preparing and filing all Tax Returns to be filed by E Com and conducting any Tax audits and proceedings relating to Pre-Closing Taxes.

(e) All tax-sharing agreements or similar agreements with respect to or involving Model and its Subsidiaries shall be terminated as of the Closing Date and, after the Closing Date, Model and its Subsidiaries shall not be bound thereby or have any liability thereunder.

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(f) All transfer, documentary, sales, use, stamp, registration and other such Taxes, and all conveyance fees, recording charges and other fees and charged (including any penalties and interest) incurred in connection with the consummation by this Agreement shall be borne by the Model Shareholders.

(i) For Tax purposes, the parties agree to treat all payments made under this Section 5.10 and under any other indemnity provisions contained in this Agreement, and for any breaches of representations, warranties, covenants or agreements, as adjustments to the Merger Consideration.

(ii) This Section 5.10 and Section 8.4(b) shall be the sole provisions governing indemnities for Taxes under this Agreement.

(iii) For purposes of this Section 5.10, all references to Model or its Affiliates shall include successors.

(iv) Notwithstanding any provision in this Agreement to the contrary, the covenants and agreements of the parties hereto contained in this Section 5.10 shall survive the Closing and shall remain in full force indefinitely.

(g) For the avoidance of doubt, no limits on indemnification contained in Section 8.1 or 9.1 shall apply to indemnification for Taxes.

5.11 Voting E Com Common Stock. Each Model Shareholder, who is an E Com Shareholder, agrees to vote his, her or its shares of E Com Common Stock in favor of the matters for which the E Com Shareholder Approval is being sought.

5.12 Filing of Listing Application and Blue Sky Forms. The parties shall use commercially reasonable efforts to file any required listing applications with Nasdaq with respect to the shares of E Com Common Stock and Warrants to be issued pursuant to the Merger and the shares of E Com Common Stock to be issued upon exercise of the Warrants and any federal or state forms, notices or other documents relating to the issuance of such securities required to be filed under applicable state or federal securities laws.

ARTICLE 6 - CONDITIONS TO THE MERGER

6.1 Conditions to Each Party's Obligation to Effect the Merger. The respective obligations of each party hereto to effect the Merger shall be subject to the satisfaction (or waiver, if permissible under applicable Law) at or prior to the Effective Time of the following conditions:

(a) E Com Shareholder Approval shall have been obtained;

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- (b) Any waiting period applicable to the consummation of the Merger under the HSR Act shall have expired or been terminated, and no action shall have been instituted by the Department of Justice or Federal Trade Commission challenging or seeking to enjoin the consummation of the Merger or the Transactions, which action shall have not been withdrawn or terminated;
- (c) E Com shall have received confirmation that the any listing application referred to in Section 5.12 shall be effective as of the Effective Time;
- (d) Asset based loans and term debt facilities in amounts and on terms substantially similar to those contemplated in the Commitment Letter shall have been obtained by Acquisition Sub and/or E Com and funds shall have been advanced and/or be available thereunder;
- (e) No Law, injunction, judgment or ruling enacted, promulgated, issued, entered, amended or enforced by any Governmental Entity shall be in effect enjoining, restraining, preventing or prohibiting consummation of the Merger or making the consummation of the Merger illegal;
- (f) The Affiliate Consignment and the issuance of the Affiliate Debt shall have been effected on or prior to the Closing.

6.2 Conditions to Model's Obligations to Effect the Merger. The obligations of Model to effect the Merger shall be subject to the satisfaction (or waiver, if permissible under applicable Law) at or prior to the Effective Time of the following conditions:

- (a) The representations and warranties of E Com set forth in this Agreement shall be true and correct as of the date of this Agreement and as of the Closing Date as though made on and as of the Closing Date, except to the extent (i) any inaccuracies in such representations and warranties, individually or in the aggregate, would not have a Material Adverse Effect on E Com (provided that, for purposes of this Section 6.2(a), any representation or warranty of E Com that is qualified by materiality (or words of similar import) or Material Adverse Effect on E Com shall be read as if such language were not present), or (ii) such representations and warranties (other than Section 3.2, which shall remain true and correct on the Closing Date, except for issuances of E Com Common Stock as a result of the exercise of outstanding options under Stock Plans) specifically speak as of an earlier date. Model shall have received a certificate executed on behalf of E Com by its Chief Executive Officer or Chief Financial Officer to such effect;
- (b) E Com shall have performed or complied in all material respects with all of its obligations and covenants required to be performed by E Com under this Agreement at or prior to the Closing Date. Model shall have received a certificate executed on behalf of E Com by its Chief Executive Officer or Chief Financial Officer to such effect;

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(c) All consents from third Persons (other than Affiliates of Model or the Model Shareholders), including Governmental Entities, necessary or advisable to be obtained in connection with the Transactions shall have been obtained and be in full force and effect, including, without limitation, consents of lessors of properties leased by E Com and its Subsidiaries (as lessor or lessee), except where the failure to obtain all requisite consents and approvals required hereby and under Section 6.3(c) (considered as a group) is not reasonably expected to have a Material Adverse Effect on E Com and Model on a consolidated basis;

(d) E Com shall have executed and delivered a Registration Rights Agreement in the form of Exhibit B hereto among it and each of the shareholders of Model providing piggyback registration rights;

(e) E Com shall have executed and delivered the Warrants; and

(f) Since the date hereof no Material Adverse Effect shall have occurred as to E Com.

6.3 Conditions to E Com's and Acquisition Subsidiaries' Obligations to Effect the Merger. The respective obligations of each of E Com and Acquisition Subsidiaries to effect the Merger shall be subject to the satisfaction (or waiver, if permissible under applicable Law) at or prior to the Effective Time of the following conditions:

(a) The representations and warranties of Model set forth in this Agreement shall be true and correct as of the date of this Agreement and as of the Closing Date as though made on and as of the Closing Date, except to the extent (i) any inaccuracies in such representations and warranties, individually or in the aggregate, would not have a Material Adverse Effect on Model (provided that, for purposes of this Section 6.3(a), any representation or warranty of Model that is qualified by materiality (or words of similar import) or Material Adverse Effect on Model shall be read as if such language were not present), or (ii) such representations and warranties (other than Section 4.2) speak as of an earlier date. E Com shall have received a certificate executed on behalf of Model by its Chief Executive Officer or Chief Financial Officer to such effect;

(b) Model shall have performed or complied in all material respects with all of its obligations and covenants required to be performed by Model under this Agreement at or prior to the Closing Date. E Com shall have received a certificate executed on behalf of Model by its Chief Executive Officer or Chief Financial Officer to such effect;

(c) All consents from third Persons, including Governmental Entities, necessary or advisable to be obtained in connection with the Transactions shall have been obtained and be in full force and effect, including, without limitation, consents of lessors of material properties leased by Model and its Subsidiaries (as lessor or lessee), except where the failure to obtain all requisite consents and approvals required hereby and under Section 6.2(c) (considered as a group) is not reasonably expected to have a Material Adverse Effect on E Com and Model on a consolidated basis;

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(d) Each of Model and Quality King Distributors, Inc. shall have executed and delivered the Transition Services Agreement dated as of a date prior to the Effective Time in a form to be mutually agreed to by Model and E Com prior to the Effective Time;

(e) Each of Model and the landlords of real estate leased by Model shall have executed and delivered the Space Agreement dated as of a date prior to the Effective Time in a form to be mutually agreed to by Model and E Com prior to the Effective Time; and

(g) Model shall cause to be delivered by each Model Shareholder the certificate of representations, including representations as to investment intent, in a form to be mutually agreed to by Model and E Com prior to the Effective Time.

ARTICLE 7 - TERMINATION.

7.1 Termination. This Agreement may be terminated and the Transactions abandoned at any time prior to the Effective Time, whether before or after E Com Shareholder Approval thereof,:

(a) By the mutual written consent of Model and E Com duly authorized by the respective Boards of Directors of Model and E Com.

(b) By either of Model or E Com, if any Governmental Entity shall have enacted, promulgated, issued, entered, amended or enforced (A) a Law prohibiting the Merger or making the Merger illegal, or (B) an injunction, judgment, order, decree or ruling, or taken any other action, in each case, permanently enjoining, restraining, preventing or prohibiting the Merger and such injunction, judgment, order, decree or ruling or other action shall have become final and non-appealable; provided, that the right to terminate this Agreement under this Section 7.1(b) shall not be available to a party if the issuance of such final, non-appealable injunction, judgment, order, decree or ruling was primarily due to the failure of such party to perform any of its obligations under this Agreement.

(c) By either of Model or E Com:

(i) if the Merger shall not have been consummated by June 30, 2008 (the Outside Date) provided, however, that that the right to terminate this Agreement under this Section 7.1(c)(i) shall not be available to any party whose failure to fulfill any obligation or condition under this Agreement has been the cause of, or resulted in, the failure of the Merger to occur on or before such Outside Date;

(ii) if E Com enters into an agreement for a Superior Proposal; or

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(iii) if the shareholders of E Com fail to give the E Com Shareholder Approval at the Shareholders Meeting, including any adjournment thereof; provided, however, that the right to terminate this Agreement under this Section 7.1(c)(iii) shall not be available to any party to this Agreement whose failure to fulfill any obligation or condition under this Agreement (or which has an Affiliate whose action or omission to act) has been the cause of, or resulted in, the failure to obtain the E Com Shareholder Approval (other than such failure, action or omission arising from any action or omission to act by the Board of Directors of E Com, as required by its fiduciary duties, as determined in good faith by the Board of Directors of E Com, in accordance with Section 5.3).

(d) By E Com, if:

(i) the representations and warranties of Model set forth in this Agreement shall not be true and correct on and as of the date of such determination as if made on such date such that the conditions set forth in Section 6.3(a) would not be satisfied, or

(ii) Model shall have breached or failed in any material respect to perform or comply with any obligation, agreement or covenant required by this Agreement to be performed or complied with by it, such that the conditions set forth in Section 6.3(b) would not be satisfied,

which, in each case under clauses (i) and (ii) of this Section 7.1(d), has not been cured within twenty (20) Business Days after Model receives from E Com written notice of such inaccuracy, breach or failure; provided, however, that E Com may only exercise this termination right prior to the Closing Date; or

(e) By Model:

(i) if the Board of Directors of E Com or any committee thereof shall have withdrawn or modified or publicly proposed to withdraw or modify in a manner adverse to Model, its approval or recommendation of this Agreement or any of the Transactions; or

(ii) if (A) the representations and warranties of E Com set forth in this Agreement shall not be true and correct on and as of the date of such determination as if made on such date such that the conditions set forth in Section 6.2(a) would not be satisfied or (B) E Com shall have breached or failed in any material respect to perform or comply with any obligation, agreement or covenant required by this Agreement to be performed or complied with by it, such that the conditions set forth in Section 6.2(b) would not be satisfied, which, in each case under clauses (A) and (B) has not been cured within twenty (20) Business Days after E Com receives from Model written notice of such inaccuracy, breach or failure; provided, however, that Model may only exercise this termination right prior to the Closing Date.

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7.2 Effect of Termination. In the event of the termination of this Agreement as provided in Section 7.1, written notice thereof shall be given to the other party or parties, specifying the provision hereof pursuant to which such termination is made, and this Agreement shall forthwith become null and void (other than the provisions of the Confidentiality Agreement most recently executed (the Confidentiality Agreement) by Model and E Com (subject to its terms), Sections 5.4 and 7.2, and Article 9, all of which shall survive termination of this Agreement for any reason, and there shall be no liability on the part of E Com or Model or their respective directors, officers and affiliates, except nothing shall relieve any party from liability for fraud or any willful breach of this Agreement.

ARTICLE 8 - INDEMNIFICATION.

8.1 Obligation to Indemnify. Subject to the limitations set forth in this Article 8, E Com shall be entitled to indemnification from and against all losses, damages and out-of-pocket expenses (including reasonable attorneys' fees and expenses of outside counsel, accountants and other professional fees, costs of investigation, court costs and other expenses) incurred by E Com in the investigation, collection, prosecution or defense of any claims, whether or not involving a third Person, suits, actions, claims, deficiencies, liabilities, penalties, and fines (but not including punitive, exemplary, consequential and all other kinds of special damages, including, without limitation, lost profits and opportunity costs, unless such punitive, exemplary, consequential or other kind of special damages are awarded to a Person in a Third-Party Claim) (Losses) sustained or incurred as a result of, relating to or caused by (i) any misrepresentation, breach of the representations and warranties of Model or a Model Shareholder contained in this Agreement or any certificate, schedule, document or other writing delivered pursuant hereto, or (ii) other than as contemplated by Article 7 and the failure to make payments under Sections 5.10 and 8.4(b), any breach of any of the covenants and agreements of Model or a Model Shareholder contained in this Agreement or any certificate, schedule, document or other writing delivered pursuant hereto; provided that E Com shall not be entitled to indemnification under this Agreement unless a claim is timely asserted during the applicable survival period specified in Section 9.1 by means of an Indemnification Notice meeting in all material respects the requirements of Section 8.2(a).

The rights of E Com to indemnification under this Section 8.1 (other than as to Pre-Closing Taxes) shall be limited as follows:

- (A) The amount of any Losses incurred by E Com shall be reduced by the net amount of the Tax Benefits actually realized by E Com or any of its Affiliates by reason of such Losses and shall be increased by the amount of any Tax to be incurred by E Com or any of its Affiliates (and grossed up for such increase) as a result of the receipt of indemnity payments with respect to any such Loss.

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- (B) The amount of any Losses incurred by E Com shall be reduced by the net amount E Com or any of its Affiliates recovers (after deducting all reasonable attorneys' fees, expenses and other costs of recovery) from any insurer or other party liable for such Losses, and E Com shall use commercially reasonable efforts to effect any such recovery.
- (C) E Com shall be entitled to indemnification under this Section 8.1 only to the extent that the aggregate amount of Losses (reduced, without duplication, as provided in paragraphs (A) and (B) above) exceeds on a cumulative basis \$1,000,000 (the Threshold), and then only for the amount of any such excess.
- (D) In no event will E Com be entitled to indemnification under this Section 8.1 for any individual item (or series of related items) of Loss (as reduced in accordance with paragraphs (A) and (B) above) that is less than \$10,000 and each such item will not be taken into account in determining whether the aggregate amount of Losses exceeds the Threshold.
- (E) In any event the maximum amount for which E Com shall be entitled to indemnification in the aggregate under this Section 8.1 (as reduced, without duplication, in accordance with paragraphs (A), (B), (C) and (D) above) shall not exceed the Escrow Fund.
- (F) Except as to Pre-Closing Taxes as provided in Sections 5.10 and 8.4(b) and Pre-Closing Covenant Breaches, the Escrow Shares and the Escrow Fund shall be the sole and exclusive remedy available to E Com for any Losses arising out of any and all claims relating to the subject matter of this Agreement, and the maximum amount that may be recovered from any Model Shareholder shall be limited to such person's pro rata share of the Escrow Shares.
- (G) For purposes of calculating the amount of Losses incurred arising out of or relating to any breach of a representation or warranty by Model or a Model Shareholder, the references to Knowledge, Material Adverse Effect or other materiality qualifications shall be disregarded.

8.2 Indemnification Notice Procedures.

(a) Promptly after the discovery of any Losses for which it may be entitled to indemnification pursuant to this Article 8, E Com shall deliver to the Shareholder Representative a notice (the Indemnification Notice), which Indemnification Notice shall:

(i) state that E Com has paid or incurred Losses for which E Com is entitled to indemnification pursuant to this Agreement; and

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(ii) specify in reasonable detail each individual item of Loss, the basis for any anticipated liability and the nature of the misrepresentation, breach of warranty or breach of covenant to which each such item is related and, if then known, the amount to which E Com claims to be entitled hereunder.

(b) In the event that the Shareholder Representative shall object to the indemnification of E Com in respect of any claim or claims specified in any Indemnification Notice, the Shareholder Representative shall, within forty-five (45) days after receipt by the Shareholder Representative of such Indemnification Notice, deliver to E Com a notice to such effect and the Shareholder Representative and E Com shall, within the sixty (60) day period beginning on the date of receipt by E Com of such objection, attempt in good faith to agree as to the disposition of each of such claims to which the Shareholder Representative shall have so objected. If E Com and the Seller Representative shall succeed in reaching agreement with respect to any of such claims, E Com and the Seller Representative shall promptly prepare and sign a memorandum setting forth such agreement. Should E Com and the Seller Representative be unable to agree as to any particular item or items or amount or amounts within such time period, then either the Indemnified Party or the Indemnifying Party may submit such dispute to arbitration as provided in Section 9.12.

(c) Claims for Losses specified in any Indemnification Notice to which the Shareholder Representative shall not object in writing within forty-five (45) days after receipt of such Indemnification Notice, claims for Losses covered by a memorandum of agreement of the nature described in Section 8.2(b), and claims for Losses the validity and amount of which have been the subject of judicial determination as described in Section 8.2(b) or shall have been settled with the consent of the Shareholder Representative, as described in Section 8.3, are hereinafter referred to, collectively, as Agreed Claims .

8.3 Third-Party Claims.

(a) E Com agrees to give the Shareholder Representative notice in writing of the assertion of any claim or demand made by, or an action, proceeding or investigation instituted by, any Person not a party to this Agreement (a Third-Party Claim) in respect of which indemnity will be sought under Section 8.1 in accordance with the notice procedures set forth in Section 8.2 promptly after E Com learns of such Third-Party Claim; provided, however, that failure to give such notice shall not affect the indemnification provided hereunder, except to the extent there shall have been actual prejudice to the defense of such Third-Party Claim by the Shareholder Representative as a result of such failure (except that there shall be no right to indemnification under this Article 8 for

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any expenses incurred during the period in which E Com failed to give such notice). Thereafter, E Com shall deliver to the Shareholder Representative, within five (5) Business Days after E Com's receipt thereof, copies of all notices and documents (including court papers) received by E Com relating to the Third-Party Claim.

(b) If a Third-Party Claim is made against E Com, the Shareholder Representative will be entitled to participate in the defense thereof. The Shareholder Representative may elect to assume the defense, at Model Shareholders' expense and by counsel selected by the Shareholder Representative, of any Third-Party Claim in accordance with the following conditions:

(i) If such Third-Party Claim involves (and continues to involve) solely monetary damages and the Shareholder Representative agrees in writing with E Com that E Com shall be entitled (subject to any applicable limitations in [Section 8.1](#)) to indemnification hereunder as to such claim and the amount of such claim can be satisfied from the Escrow Fund, then the Shareholder Representative may assume the defense of such claim and, subject to [Section 8.3\(d\)](#), may not settle such claim without the consent of E Com, which consent shall not be unreasonably withheld or delayed.

(ii) If such Third-Party Claim involves both monetary damages and injunctive relief against E Com, then the Shareholder Representative may assume the defense of such claim and may settle that portion of such claim involving solely monetary damages in accordance with clause (i) above, as applicable, mutatis mutandis, but shall not settle any portion of such claim involving injunctive relief without the consent of E Com, which consent shall not be unreasonably withheld or delayed.

(iii) If such Third-Party Claim involves (and continues to involve) solely injunctive relief against E Com, E Com shall control the defense of such claim and shall not settle any portion of such claim for monetary damages without the consent of the Shareholder Representative, which consent shall not be unreasonably withheld or delayed.

(iv) In all cases, if the parties in any action shall include both Model and/or a Model Shareholder, on the one hand, and E Com, on the other hand, and E Com shall have reasonably concluded that counsel selected by the Shareholder Representative has a conflict of interest because of the availability of conflicting defenses, E Com shall have the right to select separate counsel to participate in the defense of such action on its behalf.

(c) Subject to the foregoing, if the Shareholder Representative elects to assume the defense of such Third-Party Claim, it shall notify E Com of the Shareholder Representative's intent to do so within thirty (30) days (or sooner, if the nature of the

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Third-Party Claim so requires) of E Com's notice of such Third-Party Claim. If the Shareholder Representative is not entitled or elects not to assume the defense of the Third-Party Claim or fails to notify E Com of its election as herein provided, E Com shall have the right to conduct such defense with counsel reasonably acceptable to the Shareholder Representative, but E Com (or any insurance carrier defending such Third-Party Claim on E Com's behalf) shall be prohibited from compromising or settling the Third-Party Claim without the prior written consent of the Shareholder Representative, which consent shall not be unreasonably withheld or delayed.

(d) Subject to Section 8.3(b)(iv), should the Shareholder Representative so elect to assume the defense of a Third-Party Claim, as long as the Shareholder Representative conducts such defense, E Com shall not be entitled to indemnification under this Article 8 for legal expenses subsequently incurred by E Com in connection with the defense thereof. If the Shareholder Representative assumes such defense, E Com shall have the right to participate in the defense thereof and to employ counsel, at its own expense, separate from the counsel employed by the Shareholder Representative, it being understood that the Shareholder Representative shall control such defense. E Com shall be entitled to indemnification under this Article 8 for the fees and expenses of counsel employed by E Com for any period during which the Shareholder Representative has not assumed the defense thereof (other than during any period in which E Com shall have not yet given notice of the Third-Party Claim as provided above). If the Shareholder Representative chooses to defend or prosecute any Third-Party Claim, the Shareholder Representative and E Com shall cooperate in the defense or prosecution thereof. Such cooperation shall include the retention and (upon the Shareholder Representative's request) the provision to the Shareholder Representative of records and information that are reasonably relevant to such Third-Party Claim, and making employees available on a mutually convenient basis to provide additional information and explanation of any material provided hereunder. Whether or not the Shareholder Representative shall have assumed the defense of a Third-Party Claim, E Com shall not admit any liability with respect to, or settle, compromise or discharge, such Third-Party Claim without the Shareholder Representative's prior written consent, which consent shall not be unreasonably withheld or delayed. Notwithstanding the foregoing, if a settlement offer is made by a third-party claimant solely for money damages and does not seek equitable or other relief and the settlement is not likely to establish a precedential custom or practice adverse to the continued business interests of E Com, and the Shareholder Representative notifies in writing E Com of the Shareholder Representative's willingness to accept the settlement offer and, subject to the applicable limitations of this Article 8, cause to be paid the amount called for by such offer, and E Com declines to accept such offer, E Com may continue to contest such Third-Party Claim, free of any participation by the Shareholder Representative, and the amount of any ultimate liability with respect to such Third-Party Claim for which E Com shall be entitled to indemnification hereunder shall be limited to the lesser of (i) the amount of the settlement offer that E Com declined to accept plus the other Losses of E Com relating to such Third-Party Claim prior to the date of its rejection of the settlement offer or (ii) the aggregate Losses of E Com with respect to such Third-Party Claim.

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8.4 Payment of Claims.

(a) Each Agreed Claim (other than as to a Pre-Closing Tax or as to a Pre-Closing Covenant Breach) shall be satisfied from the Escrow Fund as follows:

(i) E Com shall notify the Shareholder Representative in writing of its intention to satisfy the Agreed Claim from the Escrow Fund.

(ii) Unless the Shareholder Representative shall have paid (or caused to be paid) to E Com by wire transfer an amount equal to the amount of such Agreed Claim within ten (10) Business Days of such written notice (a Cash Indemnity Payment), E Com may cause to be cancelled such whole number of shares of the Escrow Shares as shall equal the amount of such Agreed Claim divided by the Consideration Per Share Price rounded up to the next whole number.

(iii) If a Cash Indemnity Payment shall be made with respect to an Agreed Claim, E Com shall cause to be delivered to the Shareholder Representative for delivery to the Model Shareholders pro rata based upon their respective allocations of the Escrow Shares certificates in such denominations as the Shareholder Representative may indicate in the name of one or more of the Model Shareholders representing in the aggregate a whole number of shares of the Escrow Shares equal to the amount of such Agreed Claim divided by the Consideration Per Share Price rounded down to the next whole number.

(b) Each Agreed Claim with respect to Pre-Closing Tax shall be paid in cash by the Model Shareholders in accordance with Section 5.10.

(c) E Com shall be entitled to seek indemnity for any Agreed Claim with respect to the breach by Model of any of its covenants or agreements hereunder that was to be performed on or prior to the Closing Date (a Pre-Closing Covenant Breach) directly against Model subject to the terms and conditions of this Article 8 (other than Section 8.4(a)).

8.5 Shareholder Representative.

(a) The Shareholder Representative shall act as the representative of the Model Shareholders, and shall be authorized to act on behalf of the Model Shareholders and to take any and all actions required or permitted to be taken by the Shareholder Representative under this Agreement, with respect to any claims (including the settlement thereof) made by E Com for indemnification or to be held harmless pursuant to this Article 8. The Model Shareholders shall be bound by all actions taken by the Shareholder Representative in its capacity thereof.

(b) The Shareholder Representative shall at all times act in his or her capacity as Shareholder Representative in a manner that the Shareholder Representative believes in good faith to be in the best interest of the Model Shareholders. Neither the

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Shareholder Representative nor any of its agents shall be liable to any Person for any error of judgment, or any action taken, suffered or omitted to be taken, under this Agreement, except in the case of its gross negligence, bad faith or willful misconduct. The Shareholder Representative may consult with legal counsel, independent public accountants and other experts selected by it and shall not be liable for any action taken or omitted to be taken in good faith by it in accordance with the advice of such counsel, accountants or experts. The Shareholder Representative shall not have any duty to ascertain or to inquire as to the performance or observance of any of the terms, covenants or conditions of this Agreement. As to any matters not expressly provided for in this Agreement, the Shareholder Representative shall not be required to exercise any discretion or take any action.

(c) Each Model Shareholder severally shall indemnify and hold harmless and reimburse the Shareholder Representative from and against such Model Shareholder's ratable share of any and all Losses suffered or incurred by the Shareholder Representative arising out of or resulting from any action taken, or omitted to be taken, by the Shareholder Representative under this Agreement, other than such Losses arising out of or resulting from the Shareholder Representative's gross negligence, bad faith or willful misconduct.

ARTICLE 9 - MISCELLANEOUS.

9.1 No Survival of Representations and Warranties; etc. The representations, warranties and agreements in this Agreement shall terminate at the Effective Time except that the representations and warranties set forth in Articles 3 and 4 shall survive until the Escrow Release Date (other than those as to Taxes set forth in Section 4.9, which shall survive until expiration of the applicable statute of limitations as to Taxes), the agreements set forth in Section 5.7 shall survive the Effective Time for a period of six (6) years, the agreements set forth in Section 5.10 shall survive for the applicable statute of limitations as to Taxes and the agreements set forth in Articles 2 and 8 and this Article 9 shall survive the Effective Time indefinitely.

9.2 Amendment or Supplement. At any time prior to the Effective Time, this Agreement may be amended or supplemented in any and all respects, whether before or after approval of any of the transactions contemplated hereby by the Model Shareholders, by written agreement of the parties hereto, and by action taken by the respective Boards of Directors of E Com and Model; provided, however, that following the E Com Shareholder Approval there shall be no amendment or change to the provisions hereof which by Law would require shareholder approval without such approval.

9.3 Extension of Time, Waiver, Etc. At any time prior to the Effective Time, any party may, subject to applicable Law, (a) waive any inaccuracies in the representations and warranties of any other party hereto, (b) extend the time for the performance of any of the obligations or acts of any other party hereto or (c) waive compliance by the other party with any of the agreements

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contained herein or, except as otherwise provided herein, waive any of such party's conditions. Notwithstanding the foregoing, no failure or delay by Model or E Com in exercising any right hereunder shall operate as a waiver thereof nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right hereunder. Any agreement on the part of a party hereto to any such extension or waiver shall be valid only if set forth in an instrument in writing signed on behalf of such party.

9.4 Assignment; Binding Effect. Neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any of the parties hereto (whether by operation of law or otherwise) without the prior written consent of the other parties, except that E Com may assign any of its rights, interests or obligations hereunder to any of its Affiliates ; provided, however, that any such assignment shall not relieve E Com from its obligations hereunder. Subject to the preceding sentence, this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective heirs, executors, administrators, legal representatives, successors and permitted assigns. Any purported assignment not permitted under this Section 9.4 shall be null and void.

9.5 Counterparts; Effectiveness. This Agreement may be executed in two or more separate counterparts, each of which shall be deemed to be an original but all of which taken together shall constitute one and the same agreement. This Agreement shall become effective when each party hereto shall have received counterparts hereof signed by the other parties hereto. Signatures sent by fax or pdf shall be deemed originals.

9.6 Entire Agreement; No Third-Party Beneficiaries. This Agreement, the exhibits and schedules hereto, the Confidentiality Agreement, the E Com Disclosure Schedule and the Model Disclosure Schedule constitute the entire agreement, and supersede all other prior agreements and understandings, both written and oral, among the parties, with respect to the subject matter hereof and thereof. This Agreement is not intended to and shall not confer upon any Person other than the parties hereto any rights hereunder.

9.7 Governing Law; Enforcement; Jurisdiction; Waiver of Jury Trial.

(a) This Agreement shall be governed by and construed in accordance with the laws of the State of New York, without regard to the principles of conflicts of laws thereof that would defer to the Laws of another jurisdiction.

(b) The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties shall be entitled to seek an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement in the United States District Court for the Eastern District of New York or in New York Supreme Court sitting in Suffolk County, New York, without bond or other security being required, this being in addition to any other remedy to which they are entitled at law or in equity.

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(c) For purposes of enforcing Section 9.12 or an award of the arbitrator(s) pursuant thereto, each of the parties hereto (i) consents to submit itself to the personal jurisdiction of the United States District Court for the Eastern District of New York or in New York Supreme Court sitting in Suffolk County, New York in the event any dispute arises out of this Agreement or any of the Transactions, (ii) agrees that it will not attempt to deny or defeat such personal jurisdiction by motion or other request for leave from any such court, (iii) waives any defense of forum non conveniens, and (iv) agrees that it will not bring any action relating to this Agreement or any of the Transactions in any court other than a Federal or State court sitting in the State of New York.

(d) Each of the parties hereto hereby irrevocably waives any and all rights to trial by jury in any legal proceeding arising out of or relating to this Agreement or the Transactions.

9.8 Notices. All demands, notices, requests, consents and other communications required or permitted under this Agreement shall be in writing and shall be personally delivered or sent by facsimile machine (with a confirmation copy sent by one of the other methods authorized in this Section), reputable commercial overnight delivery service (including Federal Express and U.S. Postal Service overnight delivery service) for the next Business Day delivery, or deposited with the U.S. Postal Service mailed first class, registered or certified mail, postage prepaid, as set forth below:

If to Model, to:

Model Reorg, Inc.

2060 Ninth Avenue

Ronkonkoma, New York 11779

Attention: Michael Katz

Facsimile No.: (631) 737-5154

with a copy to:

Edwards Angell Palmer & Dodge LLP

750 Lexington Avenue

New York, NY 10022

Attention: Patricia L. Kantor, Esq.

Facsimile No.: (212) 308-4844

If to the Seller Representative to:

Stephen Nussdorf

c/o Model Reorg, Inc.

2060 Ninth Avenue

Ronkonkoma, NY 11779

Facsimile No.: 631-439-2333

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with a copy to:

Edwards Angell Palmer & Dodge LLP

750 Lexington Avenue

New York, NY 10022

Attention: Patricia L. Kantor, Esq.

Facsimile No.: (212) 308-4844

If to E Com or Acquisition Sub, to:

E Com Ventures, Inc.

251 International Parkway

Sunrise, Florida 33325

Attention: Donovan Chin

Facsimile No.: (954) 335-9166

with copies to:

Akerman Senterfitt

One Southeast Third Avenue

28th Floor

Miami, FL 33131

Attention: Alan Aronson, Esq.

Facsimile No.: (305) 374-5095

and

Special Committee of the Board of Directors of E Com Ventures, Inc.

c/o Troutman Sanders LLP

405 Lexington Avenue

New York, NY 10174

Attention: Richard A. Rubin, Esq.

Facsimile No.: (212) 704-6288

Notices shall be deemed given upon the earlier to occur of (i) receipt by the party to whom such notice is directed; (ii) if sent by facsimile machine, on the Business Day such notice is sent if sent (as evidenced by the facsimile confirmed receipt) prior to 5:00 p.m. Eastern Time and, if sent after 5:00 p.m. Eastern Time, on the first Business Day after which such notice is sent; (iii) on the first Business Day following the day the same is deposited with the commercial courier if sent by commercial overnight delivery service for next Business Day delivery; or (iv) the fifth Business Day following deposit thereof with the U.S. Postal Service as aforesaid. Each party, by notice duly given in accordance herewith, may specify a different address for the giving of any notice hereunder.

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9.9 Severability. If any term or other provision of this Agreement is determined by a court of competent jurisdiction to be invalid, illegal or incapable of being enforced by any rule of law or public policy, all other terms, provisions and conditions of this Agreement shall nevertheless remain in full force and effect. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible to the fullest extent permitted by applicable Law in an acceptable manner to the end that the transactions contemplated hereby are fulfilled to the extent possible. If the parties are unable to reach an agreement as to such modification, a court shall have the power to so modify such provision.

9.10 Headings. Headings of the Articles and Sections of this Agreement are for convenience of the parties only, and shall be given no substantive or interpretive effect whatsoever.

9.11 Definitions: Construction. As used in this Agreement, the following terms have the meanings ascribed thereto below:

Affiliate shall mean, as to any Person, any other Person which, directly or indirectly, controls, or is controlled by, or is under common control with, such Person. For this purpose, control (including, with its correlative meanings, controlled by and under common control with) shall mean the possession, directly or indirectly, of the power to direct or cause the direction of management or policies of a Person, whether through the ownership of securities or partnership or other ownership interests, by contract or otherwise.

Affiliate Consignment means the repayment by Model and its Subsidiaries of that portion, if any, of the principal amount of (plus accrued and unpaid interest on) their indebtedness to Quality King Distributors, Inc. as of the Closing Date that is in excess of \$50,000,000 by the transfer of inventory, which inventory shall be mutually designated by Model and E Com, having a book value equal to the repaid principal and accrued and unpaid interest on all of the indebtedness of Model and its Subsidiaries to Quality King Distributors and the consignment by Quality King Distributors, Inc. of such inventory to Model and/or one or more of its Subsidiaries for sale on its behalf pursuant to a consignment agreement on customary commercial terms and conditions that shall be reasonably acceptable to E Com but shall include the agreement of Quality King Distributors, Inc. not to sell such inventory other than through the Surviving Entity without the Surviving Entity's consent.

Affiliate Debt means subordinated debt payable to certain Model Shareholders on the terms and conditions described on Exhibit C attached hereto and such other terms as shall be mutually agreeable to such Model Shareholders and E Com.

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Business Day shall mean a day except a Saturday, a Sunday or other day on which the SEC or banks in the States of New York or Florida are authorized or required by Law to be closed.

Commitment Letter shall mean the commitment letter dated August 29, 2007 between General Electric Capital Corporation and E Com, as extended or modified.

Consideration Per Share Price shall mean \$23.94.

E Com Indebtedness shall mean (i) all indebtedness of E Com and its Subsidiaries for borrowed money, (ii) all obligations of E Com and its Subsidiaries for the deferred purchase price of property or assets, (iii) all obligations of E Com and its Subsidiaries evidenced by notes (including promissory notes issued in consideration for the purchase of stock or assets of any business), bonds, debentures, guarantees or other similar instruments and (iv) all capital leases, which, in the case of clauses (i) through (iv) above, shall include all accrued interest thereon and applicable prepayment premiums and any other fees, costs or expenses payable in connection therewith.

Environmental Laws shall mean all federal, foreign, state and local laws, statutes, codes, regulations, rules, ordinances, judgments, decisions and orders of any Governmental Entity (including consent decrees, administrative orders and self-implementing requirements) relating to human health, safety and protection of the environment, all as amended or reauthorized to the date hereof and through the Closing Date, including any law relating to emissions, discharges, Releases or threatened Releases of Hazardous Materials into ambient air, surface water, groundwater or land.

GAAP shall mean generally accepted accounting principles in the United States, applied on a consistent basis during the periods involved (except as may be indicated in the notes to any applicable financial statements).

Governmental Entity shall mean any federal, state or local, domestic, foreign or multinational government, court, regulatory or administrative agency, commission or authority or other governmental instrumentality.

Hazardous Materials shall mean (a) any hazardous waste as defined in the Resource Conservation and Recovery Act of 1976, 42 U.S.C. Sections 6901 et seq., as amended, to the date hereof and through the Closing Date, and regulations promulgated thereunder; (b) any hazardous substance as defined in the Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. Section 9601 et seq., as amended through the Closing Date, and regulations promulgated thereunder; (c) petroleum or petroleum products and all derivatives and constituents thereof; (d) polychlorinated biphenyls (PCBs); (e) asbestos and asbestos-containing materials; and (f) any other pollutant, contaminant, constituent or chemical regarding which liability is imposed under any Environmental Laws.

Intellectual Property means all (i) patents, patent applications, patent disclosures and inventions, whether United States or foreign, including all reissues, continuations, divisions, continuations in part and renewals and extensions thereof, (ii) internet domain

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names, trademarks and service marks whether United States or foreign, trade dress, trade names, logos and corporate names and registrations and applications for registration thereof, together with all of the goodwill associated therewith, (iii) copyrights (registered or unregistered) and copyrightable works and registrations and applications for registration thereof, (iv) mask works and registrations and applications for registration thereof, (v) computer software (including both source and object code), data, data bases and documentation thereof, (vi) trade secrets and other confidential information (including ideas, formulas, compositions, inventions (whether patentable or unpatentable and whether or not reduced to practice), know-how, manufacturing and production processes and techniques, research and development information, drawings, specifications, designs, plans, proposals, technical data, copyrightable works, financial and marketing plans and customer and supplier lists and information), (vii) other intellectual property rights and (viii) copies and tangible embodiments thereof (in whatever form or medium).

Knowledge of E Com whether or not such term is used herein in initial capitalized form, when used in this agreement in the phrase Knowledge of E Com, or similar phrases, means the actual knowledge of Donovan Chin.

Knowledge of Model whether or not such term is used herein in initial capitalized form, when used in this agreement in the phrase Knowledge of Model, or similar phrases, means the actual knowledge of each of Michael Katz and Stephen Nussdorf.

Material Adverse Effect shall mean, with respect to any party, an effect, event or change which has a material adverse effect on the business, operations, assets, liabilities, results of operations, prospects, or financial condition of such party and its Subsidiaries taken as a whole, other than effects, events or changes arising out of or resulting from (i) changes in conditions in the United States or global economy or capital or financial markets generally, including changes in interest or exchange rates, (ii) changes in general legal, regulatory, political, economic or business conditions or changes in GAAP, unless they disproportionately affect one of the parties, or (iii) any decline in the market price, or change in trading volume, of the capital stock of such party or any failure to meet publicly announced revenue or earnings projections.

Model Indebtedness shall mean (i) all indebtedness of Model and its Subsidiaries for borrowed money, (ii) all obligations of Model and its Subsidiaries for the deferred purchase price of property or assets, (iii) all obligations of Model and its Subsidiaries evidenced by notes (including promissory notes issued in consideration for the purchase of stock or assets of any business), bonds, debentures, guarantees or other similar instruments and (iv) all capital leases, which, in the case of clauses (i) through (iv) above, shall include all accrued interest thereon and applicable prepayment premiums and any other fees, costs or expenses payable in connection therewith.

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Permit(s) shall mean any approvals, consents, registrations, permits, licenses and other authorizations from any Governmental Entity.

Person shall mean an individual, a corporation, a limited liability company, a partnership, an association, a trust, or any other entity, including a Governmental Entity.

Pre-Closing Period Return means all Tax Return for periods ending on or prior to the Closing Date.

Release shall mean any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, dumping or disposing into the environment, including movement of any Hazardous Materials through or in the environment, and the abandonment or discarding of barrels, containers and other receptacles containing any Hazardous Materials, but excludes the normal application of lawn or garden chemicals such as pesticides, herbicides and fertilizers.

Remedial Action shall mean any investigation, abatement, containment, removal or remediation of any Release or threatened Release of Hazardous Materials conducted or required to be conducted pursuant to any Environmental Laws.

SEC shall mean the U.S. Securities and Exchange Commission.

Shareholder Representative shall mean initially, Glenn Nussdorf, or such other person as shall be designated in writing by a majority-in-interest of the Model Shareholders based upon the number of shares of Model held by the Model Shareholders as of the date hereof.

Special Committee means the committee of the Board of Directors of E Com established to consider the proposed Merger.

Straddle Period Return means a Tax Return (other than a Pre-Closing Period Return) required to be filed by or with respect to Model or its Subsidiaries for periods beginning prior to and ending after the Closing Date.

Subsidiary when used with respect to any Person, shall mean any corporation, limited liability company, partnership, association, trust or other entity the accounts of which would be consolidated with those of such Person in such Person's consolidated financial statements if such financial statements were prepared in accordance with GAAP, as well as any other corporation, limited liability company, partnership, association, trust or other entity, the securities or other ownership interests representing 50% or more of the ordinary voting power (or, in the case of a non-corporate entity, 50% or more of the ownership interests) of which are, as of such date, owned by such party or one or more Subsidiaries of such Person.

Tax Benefit(s) For purposes of this Agreement, E Com or any of its Affiliates shall be deemed to recognize a Tax Benefit with respect to a taxable year if, and to the extent that the aggregate liability of E Com or such Affiliate for Taxes through the end of

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such taxable year, as calculated by the E Com or such Affiliate by excluding any Tax items attributable to any Loss and the applicable indemnification payments with respect thereto from all taxable years, exceeds the actual aggregate liability of E Com or such Affiliate for Taxes through the end of such taxable year, as calculated by E Com or such Affiliate by taking into account any Tax items attributable to such Loss and the applicable indemnification payments (to the extent permitted by relevant Tax Law and treating such Tax items as the last items claimed for any taxable year).

Tax(es) means all taxes, charges, fees, levies, penalties, or other assessments imposed by any foreign or United States federal, state, tribal or local Taxing Authority, including income, excise, property, sales, use, gross receipts, windfall profits, environmental (including taxes under Code Section 59A), employment, severance, stamp, capital stock, disability, real property, personal property, sales, use, unemployment, disability, registration, value added or add-on minimum, compensating, transfer, franchise, license, payroll, withholding, social security, estimated or other taxes (including any escheat or unclaimed property obligations), in each case including any interest, penalties, or additions attributable thereto, whether disputed or not, and including any obligations to indemnify or otherwise assume or succeed to the tax liability of any other Person.

Tax Return(s) means any and all returns, declaration, report, claim for refund, or information return or statement relating to Taxes, including any schedule or attachment thereto, and including any amendment thereof.

Transactions refers collectively to this Agreement and the transactions contemplated hereby, including the Merger.

The following terms are defined in the Sections of this Agreement set forth after such term below:

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| Losses | 8.1 | Straddle Period Return | 9.11 |
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| Merger Consideration | Recitals | Subsidiary | 9.11 |
| Model | Preamble | Superior Proposal | 5.3(c) |
| Model Balance Sheet | 4.5(b) | Surviving Entity | 2.1 |
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| Model Indebtedness | 9.11 | Transactions | 9.11 |
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| Model Material Lease | 4.17 | WARN | 4.11(d) |
| Model Permitted Encumbrances | 4.16(b) | Warrants | Recitals |
| Model Shareholders | Preamble | | |
| Outside Date | 7.1(c)(i) | | |

As used in this Agreement, including shall mean including, without limitation.

Any singular term in this Agreement shall be deemed to include the plural, and any plural term the singular.

As used in this Agreement, pronouns of either gender or neuter shall include, as appropriate, the other pronoun forms

The parties hereto have participated jointly in the negotiation and drafting of this Agreement and, in the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as jointly drafted by the parties hereto and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any provision of this Agreement.

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9.12 Arbitration.

(a) After the Closing, any dispute, controversy or claim arising out of or relating to this Agreement which cannot be resolved by the parties within thirty (30) days shall be finally settled by binding arbitration administered by the American Arbitration Association in accordance with its Commercial Arbitration Rules then in effect, including its Procedures for Large, Complex Commercial Disputes, except as specifically otherwise provided in this Section 9.12. This Section 9.12 shall be construed and enforced in accordance with the Federal Arbitration Act, notwithstanding any other choice of law provision in this Agreement.

(b) Arbitration Procedures.

(i) The place of arbitration shall be New York, New York before a single neutral arbitrator, unless any party's claim exceeds Two Million Dollars (\$2,000,000), exclusive of interest and attorneys' fees, in which case the dispute shall be heard and determined by three neutral arbitrators.

(ii) The arbitrator(s) shall allow such discovery as the arbitrator(s) determine appropriate under the circumstances, including examination by deposition of witnesses. Depositions shall be held within thirty (30) days of the making of the request, limited to a maximum of three per party and no more than six hours duration each. Any dispute regarding discovery shall be determined by the arbitrator(s) and all discovery shall be completed within one hundred and twenty (120) days after the selection of the arbitrator(s).

(iii) The decision of the arbitrator(s) shall be made within nine (9) months of the filing of the notice of intention to arbitrate (demand). The award shall be in writing and shall set forth the reasons for the disposition of any claim, and the arbitrator(s) shall have thirty (30) days thereafter to reconsider and modify such decision if any party so requests within ten (10) days after the decision.

(iv) The decision of the arbitrator(s) shall be final, binding, and non-appealable with respect to all persons, including (without limitation) persons who have failed or refused to participate in the arbitration process.

(c) The arbitrator(s) shall have authority to award relief under legal or equitable principles, including interim or preliminary relief, and to allocate responsibility for the costs of the arbitration and to award recovery of reasonable attorneys' fees and expenses in such manner as is determined to be appropriate by the arbitrator(s).

(d) Judgment upon the award rendered by the arbitrator(s) may be entered in any court having personal and subject matter jurisdiction.

(e) All proceedings under this Section 9.12, and all evidence given or discovered pursuant hereto, shall be maintained in confidence by all parties and by the arbitrator(s) except to the extent required by legal process.

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9.13 Model Shareholders Consent. By his, her or its execution hereof, each of the Model Shareholders hereby consents to the Merger.

[Remainder of Page Intentionally Left Blank.]

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IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and delivered as of the date first above written.

MODEL REORG, INC.

By: /s/ Michael W. Katz
Name: Michael W. Katz
Title: Executive Vice President

E COM VENTURES, INC.

By: /s/ Donovan Chin
Name: Donovan Chin
Title: Chief Financial Officer and Secretary

MODEL REORG ACQUISITION LLC

By its Sole Member E Com Ventures, Inc.

By: /s/ Donovan Chin
Name: Donovan Chin
Title: Chief Financial Officer and Secretary

[Model Shareholder Signatures Follow]

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The undersigned, Model Shareholders, solely for purposes of agreeing to be bound by Section 5.10 and 5.11 and Article IX of the Agreement and acknowledging the other terms and provisions of the Agreement have executed this Agreement as of the date first above written.

/s/ Glenn Nussdorf
Glenn Nussdorf

/s/ Stephen Nussdorf
Stephen Nussdorf

/s/ Arlene Nussdorf
Arlene Nussdorf

/s/ Rene Garcia
Rene Garcia

THE JACQUELINE MARIE GARCIA 2006
FAMILY TRUST u/t/a dated October 30, 2006

By: /s/ Rene Garcia
RENE A. GARCIA, Trustee

By: /s/ Rafael Villoldo
RAFAEL VILLOLDO, Trustee

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THE CAROLINA MARIE GARCIA 2006

FAMILY TRUST u/t/a dated October 30, 2006

By: /s/ Rene Garcia
RENE A. GARCIA, Trustee

By: /s/ Rafael Villoldo
RAFAEL VILLOLDO, Trustee

IRREVOCABLE TRUST FOR VICTOR GARCIA u/t/a
dated October 30, 2006

By: /s/ Rene Garcia
RENE A. GARCIA, Trustee

By: /s/ Rafael Villoldo
RAFAEL VILLOLDO, Trustee

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Schedule 2.7

Allocation of Merger Consideration and Escrow Shares

The Merger Consideration and Escrow Shares shall be allocated among the holders of Model Common Stock based on the percentages set forth below:

| | |
|--|----------|
| Glenn Nussdorf | 29.5838% |
| Stephen Nussdorf | 29.5838% |
| Arlene Nussdorf | 29.5838% |
| Rene Garcia | 5.8492% |
| Carolina Marie Garcia | 1.7998% |
| 2006 Trust u/t/a dated October 30, 2006 | |
| Jacqueline Marie Garcia | 1.7998% |
| 2006 Trust u/t/a dated October 30, 2006 | |
| Irrevocable Trust for Victor Garcia u/t/a dated October 30, 2006 | 1.7998% |

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Exhibit A

THE WARRANT REPRESENTED BY THIS CERTIFICATE AND THE SECURITIES ISSUABLE UPON EXERCISE HEREOF HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 AND MAY NOT BE OFFERED OR SOLD EXCEPT PURSUANT TO A REGISTRATION STATEMENT UNDER SUCH ACT OR AN OPINION OF COUNSEL REASONABLY SATISFACTORY TO THE ISSUER THAT AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT IS AVAILABLE. THE TRANSFER OF THE WARRANT IS FURTHER RESTRICTED AS DESCRIBED HEREIN.

E COM VENTURES, INC.

Common Stock Purchase Warrant

No. A-[]

[] Shares

Date of Issuance: [], 2008

This Common Stock Purchase Warrant (this Warrant) certifies that, for value received, [] (the Holder), is entitled, upon the terms and subject to the limitations and exceptions set forth herein, at any time and from time to time during the period beginning at 12:01 a.m. New York time on the third (3rd) anniversary of the Date of Issuance (the Initial Exercise Date) and ending at 5:00 p.m. New York time on the tenth (10th) anniversary of the Date of Issuance (the Termination Date), to subscribe for and purchase from E Com Ventures, Inc., a Florida corporation (the Company), up to an aggregate of [] ([]) shares (subject to adjustment from time to time pursuant to the terms hereof) (the Warrant Shares) of the Company's Common Stock, \$0.01 par value (the Common Stock). The purchase price of one Warrant Share (the Exercise Price) under this Warrant shall be \$23.94 (subject to adjustment from time to time pursuant to the terms hereof). This Warrant is one of a series of warrants issued as of the date hereof (the Warrants) pursuant to the Agreement and Plan of Merger dated as of December 21, 2007, by and among the Company, Model Reorg, Inc., the stockholders of Model Reorg, Inc. and Model Reorg Acquisition LLC (the Merger Agreement).

1. Exercise of Warrant.

(a) The purchase rights represented by this Warrant may be exercised by delivery of the Notice of Exercise Form annexed hereto duly executed, at the office of the Company specified in Section 13(j) hereto and upon payment of the Exercise Price of the shares thereby purchased by wire transfer or cashier's check drawn on a United States bank. Promptly after the Date of Exercise, subject to (i) compliance with securities laws applicable to the issuance and sale of the Warrant Shares and (ii) the Company's receipt of this Warrant, the Company's transfer agent shall transmit certificates for Warrant Shares purchased hereunder to the Holder at the address specified in the Notice of Exercise Form. This Warrant shall be deemed to have been exercised and the Holder shall be deemed to have become the holder of record of such shares for all purposes as of the Date of Exercise, notwithstanding that the transfer books of the Company shall then be closed or certificates representing such Warrant Shares shall not then have been actually delivered. A Date of Exercise means the date on which the Holder shall have delivered to the Company the Notice of Exercise Form appropriately completed and duly signed and payment of the Exercise Price for the number of Warrant Shares so indicated by the Holder to be purchased.

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(b) If this Warrant shall have been exercised in part, the Company shall, promptly following receipt of this Warrant, deliver to the Holder at the address specified by the Holder in the Notice of Exercise Form a new Warrant evidencing the rights of the Holder to purchase the unpurchased Warrant Shares called for by this Warrant, which new Warrant shall in all other respects be identical with this Warrant.

2. No Fractional Shares or Scrip. No fractional shares or scrip representing fractional shares shall be issued upon the exercise of this Warrant. In lieu of any fraction of a share that the Holder would otherwise be entitled to purchase upon such exercise, such fraction shall be rounded up (for fractions of one-half or greater) or down (for fractions of less than one-half) to the nearest whole share.

3. Charges, Taxes and Expenses. Certificates for Warrant Shares shall be issued without charge to the Holder for any issue or transfer tax or other incidental expense in respect of the issuance of such certificate, all of which taxes and expenses shall be paid by the Company.

4. Restriction on Transfer of Warrant and Warrant Shares. The Holder may not sell, transfer, assign, or otherwise dispose of this Warrant or any part hereof except (a) by will or by the laws of descent and distribution or (b) during the Holder's lifetime, to any member of the Holder's family or to any trust or other entity established for estate planning purposes, the majority of the beneficial interests in which are held by members of the Holder's family. Other than pursuant to clause (a) or (b), the Holder (including any such subsequent Holder) may not sell, transfer, assign, or otherwise dispose of this Warrant or any part hereof to any other person without the prior, express written consent of the Company. The transfer of the Warrant Shares shall be restricted to the extent required by applicable securities laws, and the certificate or certificates evidencing the Warrant Shares shall bear the following legend:

THE ISSUANCE OF THE SHARES REPRESENTED BY THIS CERTIFICATE HAS NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 AND SUCH SHARES MAY NOT BE OFFERED OR SOLD EXCEPT PURSUANT TO A REGISTRATION STATEMENT UNDER SUCH ACT OR AN OPINION OF COUNSEL REASONABLY SATISFACTORY TO THE ISSUER THAT AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT IS AVAILABLE.

5. No Rights as Shareholder until Exercise. This Warrant does not entitle the Holder to any voting rights or other rights as a shareholder of the Company before the exercise hereof.

6. Loss, Theft, Destruction or Mutilation of Warrant. Upon receipt by the Company of evidence reasonably satisfactory to it of the loss, theft, destruction or mutilation of this Warrant or any stock certificate representing Warrant Shares, and in case of loss, theft or destruction, of indemnity or security reasonably satisfactory to it (which, in the case of the Warrant, shall not include the posting of any bond), and upon surrender and cancellation of such Warrant or stock certificate, if mutilated, the Company will make and deliver a new Warrant or stock certificate of like tenor and dated as of such cancellation, in lieu of such Warrant or stock certificate.

7. Acceleration of Initial Exercise Date. At any time before the third (3rd) anniversary of the Date of Issuance, the Initial Exercise Date shall be accelerated and shall be deemed to occur immediately before the consummation of any (a) merger, share exchange or

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consolidation of the Company with or into any other person or entity, (b) sale of all or substantially all of the Company's assets in one or a series of related transactions, or (c) tender offer or exchange offer pursuant to which holders of not less than ninety percent (90%) of the then outstanding shares of Common Stock tender or exchange their shares for other securities, cash or property, other than any such transaction as a result of which holders of a majority of the voting securities of the Company outstanding immediately before such transaction would continue to have beneficial ownership, directly or indirectly, of a majority of the combined voting power of the Company or the surviving entity (including any person that, as a result of such transaction, owns all or substantially all of the Company's assets either directly or through one or more subsidiaries) outstanding immediately after such transaction.

8. Adjustments of Exercise Price and Number of Warrant Shares. The number and kind of securities purchasable upon the exercise of this Warrant and the Exercise Price shall be subject to adjustment from time to time. In case the Company shall (i) pay a dividend in shares of Common Stock or make a distribution in shares of Common Stock to holders of its outstanding Common Stock, (ii) subdivide its outstanding shares of Common Stock into a greater number of shares, (iii) combine its outstanding shares of Common Stock into a smaller number of shares of Common Stock, or (iv) issue any shares of its capital stock in a reclassification of the Common Stock or a compulsory share exchange, then the number of Warrant Shares purchasable upon exercise of this Warrant immediately prior thereto shall be adjusted so that the Holder shall be entitled to receive the kind and number of Warrant Shares or other securities of the Company that he or she would have owned or have been entitled to receive had such Warrant been exercised in advance thereof. Upon each such adjustment of the kind and number of Warrant Shares or other securities of the Company that are purchasable hereunder, the Holder shall thereafter be entitled to purchase the number of Warrant Shares or other securities resulting from such adjustment at an Exercise Price per Warrant Share or other security obtained by multiplying the Exercise Price in effect immediately before such adjustment by the number of Warrant Shares purchasable hereunder immediately before such adjustment, and dividing such product by the number of Warrant Shares or other securities of the Company resulting from such adjustment. An adjustment made pursuant to this paragraph shall become effective immediately after the effective date of such event retroactive to the record date, if any, for such event, subject to the effect of any exercise hereof between such record date and such effective date.

9. Fundamental Transactions. If, at any time while this Warrant is outstanding, (a) the Company effects any merger, share exchange or consolidation of the Company with or into any other person or entity, (b) the Company effects any sale of all or substantially all of its assets in one or a series of related transactions, (c) any tender offer or exchange offer (whether by the Company or another person or entity) is completed pursuant to which holders of Common Stock are permitted to tender or exchange their shares for other securities, cash or property, or (d) the Company effects any reclassification of the Common Stock or any compulsory share exchange pursuant to which the Common Stock is effectively converted into or exchanged for securities of any other issuer, cash or property (in any such case, a Fundamental Transaction), then the Holder shall have the right thereafter to receive, upon exercise of this Warrant, the same amount and kind of securities, cash or property as it would have been entitled to receive upon the occurrence of such Fundamental Transaction if it had been, immediately before such Fundamental Transaction, the holder of the number of Warrant Shares then issuable upon exercise in full of this Warrant (the Alternate Consideration). For purposes of any such exercise, the

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determination of the Exercise Price shall be appropriately adjusted to apply to such Alternate Consideration based on the amount of Alternate Consideration issuable in respect of one share of Common Stock in such Fundamental Transaction, and the Company shall apportion the Exercise Price among the Alternate Consideration in a reasonable manner reflecting the relative value of any different components of the Alternate Consideration. If holders of Common Stock are given any choice as to the securities, cash or property to be received in a Fundamental Transaction, then the Holder shall be given the same choice as to the Alternate Consideration it receives upon any exercise of this Warrant following such Fundamental Transaction. To the extent necessary to effectuate the foregoing provisions, any successor to the Company or surviving entity in such Fundamental Transaction shall issue to the Holder a new warrant consistent with the foregoing provisions and evidencing the Holder's right to exercise such warrant into Alternate Consideration; provided that this Warrant shall have been cancelled or amended to the extent such cancellation or amendment is necessary so that such new warrant does not unjustly or disproportionately enrich the holder of the new warrant relative to a holder of the number of Shares for which this Warrant is exercisable immediately before such event. The terms of any agreement pursuant to which a Fundamental Transaction is effected shall include terms requiring any such successor or surviving entity to comply with the provisions of this Section 9 and ensuring that this Warrant (or any such replacement security) will be similarly adjusted upon any subsequent transaction analogous to a Fundamental Transaction.

10. Notice of Adjustment. Whenever the number of Warrant Shares or number or kind of securities or other property purchasable upon the exercise of this Warrant or the Exercise Price is adjusted, as herein provided, the Company shall promptly give notice thereof to the Holder, which notice shall state the number of Warrant Shares (and other securities or property) purchasable upon the exercise of this Warrant and the Exercise Price of such Warrant Shares (and other securities or property) after such adjustment, setting forth a brief statement of the facts requiring such adjustment and setting forth the computation by which such adjustment was made. Irrespective of any adjustments in the Exercise Price or the number or kind of shares purchasable upon the exercise of this Warrant, Warrants theretofore or thereafter issued may continue to express the same price and number and kind of shares as are stated in this Warrant.

11. Notice of Corporate Action. If at any time: (a) the Company shall take a record of the holders of its Common Stock for the purpose of entitling them to receive a dividend or other distribution, or any right to subscribe for or purchase any evidences of its indebtedness, any shares of stock of any class or any other securities or property, or to receive any other right, or (b) there shall be any capital reorganization of the Company, any reclassification or recapitalization of the capital stock of the Company, or any consolidation, share exchange or merger of the Company with, or any sale, transfer or other disposition of all or substantially all the property, assets or business of the Company to, another person or entity, or (c) there shall be a voluntary or involuntary dissolution, liquidation or winding up of the Company, the Company shall give the Holder (i) at least ten (10) days' prior written notice of the date on which a record date shall be selected for such dividend, distribution or right or for determining rights to vote in respect of any such reorganization, reclassification, merger, share exchange, consolidation, sale, transfer, disposition, liquidation or winding up, and (ii) in the case of any such reorganization, reclassification, merger, share exchange, consolidation, sale, transfer, disposition, dissolution, liquidation or winding up, at least ten (10) days' prior written notice of the date when the same shall take place. Such

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notice in accordance with the foregoing clause also shall specify (i) the date on which any such record is to be taken for the purpose of such dividend, distribution or right, the date on which the holders of Common Stock shall be entitled to any such dividend, distribution or right, and the amount and character thereof, and (ii) the date on which any such reorganization, reclassification, merger, share exchange, consolidation, sale, transfer, disposition, dissolution, liquidation or winding up is to take place and the time, if any such time is to be fixed, as of which the holders of Common Stock shall be entitled to exchange their shares for securities or other property deliverable upon such disposition, dissolution, liquidation or winding up.

12. Covenants. The Company covenants that:

(a) during the period the Warrant is outstanding, it will reserve from its authorized and unissued Common Stock a sufficient number of shares to provide for the issuance of the Warrant Shares upon the exercise hereof;

(b) its issuance of this Warrant shall constitute full authority to its officers who are charged with the duty of executing stock certificates to execute and issue the necessary certificates for the Warrant Shares upon the exercise hereof;

(c) it will take all such reasonable action as may be necessary to assure that such Warrant Shares may be issued as provided herein without violation of any applicable law or regulation, or of any requirements of the Principal Market (as defined in Section 13(k)) upon which the Common Stock may be listed at such time;

(d) it will not close its stockholder books or records in any manner that prevents the timely exercise of this Warrant pursuant to the terms hereof;

(e) all Warrant Shares that may be issued upon exercise hereof will, upon such exercise, be duly authorized, validly issued, fully paid and nonassessable and free from all taxes, liens and charges in respect of the issue thereof;

(f) except as and to the extent waived or consented to by the Holder, the Company shall not by any action, including, without limitation, amending its articles of incorporation or through any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms of this Warrant, but will at all times in good faith assist in the carrying out of all such terms and in the taking of all such actions as may be necessary or appropriate to protect the rights of Holder as set forth in this Warrant against impairment (and without limiting the generality of the foregoing, the Company will (i) not increase the par value of any Warrant Shares above the amount payable therefor upon such exercise immediately before such increase in par value, (ii) take all such action as may be necessary or appropriate in order that the Company may validly and legally issue fully paid and nonassessable Warrant Shares upon the exercise of this Warrant, and (iii) use commercially reasonable efforts to obtain all such authorizations, exemptions or consents from any public regulatory body having jurisdiction thereof as may be necessary to enable the Company to perform its obligations under this Warrant); and

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(g) before taking any action that would result in an adjustment in the number of Warrant Shares for which this Warrant is exercisable or in the Exercise Price, the Company shall obtain all such authorizations or exemptions thereof, or consents thereto, as may be necessary from any public regulatory body or bodies having jurisdiction thereof.

13. Miscellaneous.

(a) Saturdays, Sundays, Holidays, etc. If the last or appointed day for the taking of any action or the expiration of any right required or granted herein (including without limitation the Termination Date) is not a Business Day, then such action may be taken or such right may be exercised on the next succeeding Business Day. As used in this Warrant, a Business Day is any day that is not a Saturday, a Sunday or a legal holiday in the States of New York or Florida.

(b) Governing Law; Dispute Resolution. All questions concerning the construction, validity, enforcement and interpretation of this Warrant shall be governed by the internal laws of the State of New York, without giving effect to any choice of law or conflict of law provision or rule (whether of the State of New York or any other jurisdictions) that would cause the application of the laws of any jurisdictions other than the State of New York. The dispute resolution provisions of the Merger Agreement shall apply to all disputes arising hereunder as if set forth in full herein. EACH PARTY HEREBY IRREVOCABLY WAIVES ANY RIGHT IT MAY HAVE, AND AGREES NOT TO REQUEST, A JURY TRIAL FOR THE ADJUDICATION OF ANY DISPUTE HEREUNDER OR IN CONNECTION HERewith OR ARISING OUT OF THIS WARRANT OR ANY TRANSACTION CONTEMPLATED HEREBY.

(c) Nonwaiver. No course of dealing or any delay or failure to exercise any right hereunder on the part of the Holder shall operate as a waiver of such right or otherwise prejudice the Holder's rights, powers or remedies.

(d) Limitation of Liability. No provision hereof, in the absence of any affirmative action by the Holder to exercise this Warrant or purchase Warrant Shares, and no enumeration herein of the rights or privileges of the Holder, shall give rise to any liability of the Holder for the purchase price of any Common Stock or as a stockholder of the Company, whether such liability is asserted by the Company or by creditors of the Company.

(e) Remedies. The Holder, in addition to being entitled to exercise all rights granted by law, including recovery of damages, will be entitled to specific performance of its rights under this Warrant. The Company agrees that monetary damages would not be adequate compensation for any loss incurred by reason of a breach by it of the provisions of this Warrant and hereby agrees to waive the defense in any action for specific performance that a remedy at law would be adequate.

(f) Successors and Assigns. Subject to applicable securities laws, this Warrant and the rights and obligations evidenced hereby shall inure to the benefit of and be binding upon the successors of the Company and the successors and permitted assigns of the Holder. The provisions of this Warrant are intended to be for the benefit of all Holders from time to time of this Warrant and shall be enforceable by any such Holder or holder of Warrant Shares.

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(g) Amendment. This Warrant may be modified or amended or any provision hereof waived with the written consent of the Company and the holders of Warrants issued under the Merger Agreement representing two-thirds of the Warrant Shares issuable under Warrants then outstanding as of the date such consent is sought; provided, however, that (i) no such amendment shall adversely affect any holder of any such Warrant differently than it affects all other such holders unless such holder consents thereto and (ii) no amendment may increase the Exercise Price, decrease the number of shares or class of shares obtainable upon exercise of this Warrant or decrease the time period in which this Warrant can be exercised without the written consent of the Holder.

(h) Severability. Wherever possible, each provision of this Warrant shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Warrant shall be prohibited by or invalid under applicable law, such provision shall be ineffective to the extent of such prohibition or invalidity, without invalidating the remainder of such provisions or the remaining provisions of this Warrant.

(i) Headings. The headings used in this Warrant are for the convenience of reference only and shall not, for any purpose, be deemed a part of this Warrant.

(j) Notices. Any and all notices or other communications or deliveries hereunder (including without limitation any Notice of Exercise Form) shall be in writing and shall be deemed given and effective on the earliest of (i) the date of transmission, if such notice or communication is delivered via electronic mail or facsimile at the electronic mail address or facsimile number specified in this section before 5:00 p.m. (New York City time) on a Business Day, (ii) the next Business Day after the date of transmission, if such notice or communication is delivered via electronic mail or facsimile at the electronic mail address or facsimile number specified in this section on a day that is not a Business Day or later than 5:00 p.m. (New York City time) on any Business Day, (iii) the Business Day following the date of mailing, if sent by nationally recognized overnight courier service, or (iv) upon actual receipt by the party to whom such notice is required to be given. The addresses for such communications shall be:

(x) if to the Company, to:

E Com Ventures, Inc.
Attn: []
251 International Parkway
Sunrise, Florida 33325
Facsimile: []
Email: []

(y) if to the Holder, to the address, facsimile number, or email address, respectively, set forth in [].

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IN WITNESS WHEREOF, the Company has caused this Warrant to be executed by its officer thereunto duly authorized.

Dated: [], 2008

E COM VENTURES, INC.

By:
Name:
Title:

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NOTICE OF EXERCISE

To: E Com Ventures, Inc.

The undersigned hereby elects to purchase _____ Warrant Shares of E Com Ventures, Inc. pursuant to the terms of the attached Warrant, and tenders herewith payment of the exercise price of such Warrant Shares in full, in lawful money of the United States, together with all applicable transfer taxes, if any.

Please issue a certificate or certificates representing said Warrant Shares in the name of the undersigned.

The Warrant Shares shall be delivered to the following:

SIGNATURE OF HOLDER

Dated as of:

HOLDER

By:

Print Name:

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ASSIGNMENT FORM

{Assignment of the foregoing Warrant is restricted as described therein.}

(To assign the foregoing Warrant, execute this form and supply required information.

Do not use this form to exercise the Warrant.)

FOR VALUE RECEIVED, the foregoing Warrant and all rights evidenced thereby are hereby assigned to:

Name of Assignee:

Assignee's Address:

Date:

Holder's Signature:

Holder's Address:

Signature Guaranteed:

NOTE: The signature to this Assignment Form must correspond with the name as it appears on the face of the Warrant, without alteration or enlargement or any change whatsoever, and must be guaranteed by a participant in the Medallion guaranty program. Officers of corporations and those acting in a fiduciary or other representative capacity must file proper evidence of authority to assign the foregoing Warrant.

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Exhibit B

E COM VENTURES, INC.

REGISTRATION RIGHTS AGREEMENT

THIS REGISTRATION RIGHTS AGREEMENT (this Agreement) is made as of the day of , 2008, by and among E Com Ventures, Inc., a Florida corporation (the Company), and each of the shareholders of Model Reorg, Inc., a New York corporation (Model Reorg), listed on Schedule A hereto.

RECITALS

WHEREAS, the Company, Model Reorg Acquisition LLC, a Delaware limited liability company, Model Reorg and the Shareholders have entered into an Agreement and Plan of Merger dated as of December 21, 2007 (the Merger Agreement) pursuant to which the Shareholders will receive, in exchange for their shares of Model Reorg common stock, shares of the Company s common stock, par value \$0.01 per share (the Common Stock) and Common Stock Purchase Warrants to acquire Common Stock (the Warrants); and

WHEREAS, it is a condition of the Merger Agreement that the parties hereto enter into this Agreement providing for the Company to register the shares of Common Stock issuable to the Shareholders under the Merger Agreement (excluding any Common Stock issued or issuable upon exercise of any of the Warrants) as set forth herein;

NOW, THEREFORE, the parties hereby agree as follows:

1. DEFINITIONS. For purposes of this Agreement:

1.1 Common Stock means shares of the Company s common stock, par value \$0.01 per share.

1.2 Company means E Com Ventures, Inc., any successor thereto by operation of law, and any other company whose shares are issued upon conversion of, or whose shares are exchanged for, substantially all of the outstanding shares of Common Stock pursuant to a merger, consolidation or other recapitalization transaction.

1.3 Damages means any loss, damage, or liability (joint or several) to which a party hereto may become subject under the Securities Act, the Exchange Act, or other federal or state law, insofar as such loss, damage, or liability (or any action in respect thereof) arises out of or is based upon (i) any untrue statement or alleged untrue statement of a material fact contained in any registration statement of the Company filed pursuant hereto, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto; (ii) an omission or alleged omission to state therein a material fact required to be stated therein, or necessary to make the statements therein not misleading; or (iii) any violation or alleged violation by the indemnifying party (or any of its agents or affiliates) of the Securities Act, the Exchange Act, any state securities law, or any rule or regulation promulgated under the Securities Act, the Exchange Act, or any state securities law based upon, or arising out of, any of such party s obligations arising hereunder.

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1.4 Exchange Act means the Securities Exchange Act of 1934, as amended from time to time, and the rules and regulations promulgated thereunder.

1.5 Excluded Registration means (i) a registration of the sale of securities to directors, employees or consultants of the Company or a subsidiary pursuant to a bona fide compensatory arrangement; (ii) a registration relating to an SEC Rule 145 transaction; (iii) a registration on any form that does not include substantially the same information as would be required to be included in a registration statement covering the sale of the Registrable Securities; (iv) a registration solely of debt or nonconvertible preferred stock; or (v) a registration in which the only Common Stock being registered is Common Stock issuable upon conversion of debt securities that are also being registered.

1.6 GAAP means generally accepted accounting principles in the United States.

1.7 Immediate Family Member means a child, stepchild, grandchild, parent, stepparent, grandparent, spouse, domestic partner, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, including adoptive relationships, of a natural person referred to herein.

1.8 Majority in Interest means Shareholders holding a majority of the Registrable Securities as to which Shareholders have requested inclusion in a registration under Section 2.1.

1.9 Participating Holder means a holder of Company securities that is described in clause (a) of Section 2.8 and that, in compliance with Section 2.8, has acquired rights to have such securities registered under the Securities Act by having them included in a registration statement filed by the Company.

1.10 Person means any individual, corporation, partnership, trust, limited liability company, association or other entity.

1.11 Registrable Securities means those shares of Common Stock issued pursuant to the Merger Agreement (other than (i) any that have been transferred by a Shareholder in a transaction in which the applicable rights under this Agreement are not assigned pursuant to Section 3.1, (ii) any for which registration rights have terminated pursuant to Section 2.9, and (iii) any Common Stock issued or issuable upon exercise of any of the Warrants) and all shares of Common Stock or other securities issued upon conversion or exchange or otherwise in respect thereof, including without limitation pursuant to any stock dividend, stock split, merger, consolidation or other recapitalization transaction.

1.12 Restated Certificate means the Amended and Restated Certificate of Incorporation of the Company.

1.13 SEC means the Securities and Exchange Commission.

1.14 SEC Rule 144 means Rule 144 promulgated by the SEC under the Securities Act, as in effect from time to time.

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1.15 SEC Rule 145 means Rule 145 promulgated by the SEC under the Securities Act, as in effect from time to time.

1.16 Securities Act means the Securities Act of 1933, as amended from time to time, and the rules and regulations promulgated thereunder.

1.17 Selling Expenses means all underwriting discounts, selling commissions, and stock transfer taxes applicable to the sale of Registrable Securities, and the fees and expenses of counsel to the selling Shareholders.

1.18 Shareholder means a shareholder of Model Reorg listed on Schedule A and his, her or its respective successors and other assigns complying with Section 3.1.

2. REGISTRATION RIGHTS. The Company covenants and agrees as follows:

2.1 Company Registration. Promptly after the Company determines to register (including, for this purpose, a registration by the Company for holders of Common Stock other than the Shareholders) any of its securities under the Securities Act in connection with the public offering of such securities solely for cash (other than in an Excluded Registration), the Company shall give each Shareholder written notice of such proposed registration. Upon the request of any Shareholder given within twenty (20) days after such notice, the Company shall, subject to the provisions of Section 2.2, cause to be registered all of the Registrable Securities that each such Shareholder has requested to be included in such registration.

2.2 Underwriting Requirements.

(a) If the Shareholders intend to distribute the Registrable Securities covered by their registration request by means of an underwriting, they shall so advise the Company and will select (by a Majority in Interest) such underwriter(s) as shall be reasonably acceptable to the Company. In such event, the right of any Shareholder to include such Shareholder's Registrable Securities in such registration shall be conditioned upon such Shareholder's participation in such underwriting and the inclusion of such Shareholder's Registrable Securities in the underwriting to the extent provided herein. All Shareholders proposing to distribute their securities through such underwriting shall (together with the Company as provided in Section 2.3(e)) enter into an underwriting agreement in customary form with the underwriter(s) selected for such underwriting.

(b) Notwithstanding any other provision of this Section 2.2, if the underwriter(s) referred to in clause (a) advise(s) such Shareholders in writing that marketing factors require a limitation on the number of shares to be underwritten, the maximum number of Registrable Securities and securities to be registered on behalf of all Participating Holders that may be included in the underwriting shall be allocated among such Shareholders and Participating Holders in proportion (as nearly as practicable) to the number of Registrable Securities for which each Shareholder and Participating Holder requested registration; provided, however, that the number of Registrable Securities held by the Shareholders to be included in such underwriting shall not be reduced unless all other securities (other than securities to be sold by the Company and Participating Holders) are first entirely excluded from the underwriting.

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(c) For purposes of any apportionment under Section 2.2(b), a Shareholder and any of such Shareholder's transferees shall be deemed to be a single Shareholder, and any pro rata reduction with respect to such Shareholder shall be based upon the aggregate number of Registrable Securities owned by all Persons included in such Shareholder, as defined in this sentence.

2.3 **Obligations of the Company.** Whenever required under this Section 2 to effect the registration of any Registrable Securities, the Company shall, as expeditiously as reasonably possible:

(a) prepare and file with the SEC a registration statement with respect to such Registrable Securities and use its best efforts to cause such registration statement to become effective and, upon the request of a Majority in Interest, keep such registration statement effective for a period of up to one hundred twenty (120) days or, if earlier, until the distribution contemplated in the registration statement has been completed; provided, however, that (i) such 120-day period shall be extended for a period of time equal to the period the Shareholders refrain, at the written request of an underwriter of Common Stock (or other securities) of the Company, from selling any securities included in such registration and (ii) in the case of any registration of Registrable Securities that are intended to be offered on a continuous or delayed basis, such 120-day period shall be extended for up to an additional sixty (60) days, if necessary, to keep the registration statement effective until all such Registrable Securities are sold;

(b) subject to clause (i), prepare and file with the SEC such amendments and supplements to such registration statement, and the prospectus used in connection with such registration statement, as may be necessary to keep such registration statement effective for the period specified in clause (a) and to comply with the Securities Act in order to enable the disposition of all securities covered by such registration statement;

(c) furnish to the selling Shareholders such numbers of copies of the prospectus, including a preliminary prospectus, included in the registration statement, and such other documents, as the Shareholders may reasonably request in order to facilitate their disposition of their Registrable Securities;

(d) use its commercially reasonable efforts to register and qualify the securities covered by such registration statement under such other securities or blue-sky laws of such jurisdictions as shall be reasonably requested by the selling Shareholders; provided that the Company shall not be required to qualify to do business or to file a general consent to service of process in any such states or jurisdictions unless the Company is already subject to service in such jurisdiction and except as may be required by the Securities Act;

(e) in the event of any underwritten public offering, enter into and perform its obligations under an underwriting agreement, in usual and customary form, with the underwriter(s) of such offering;

(f) promptly make available (subject to reasonable confidentiality requirements) for inspection by the selling Shareholders, any underwriter(s) participating in any disposition pursuant to such registration statement, and any attorney or accountant or other agent retained by any such underwriter or selected by the selling Shareholders, all financial and other records,

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pertinent corporate documents, and properties of the Company, and cause the Company's officers, directors, employees, and independent accountants to supply all information reasonably requested by any such seller, underwriter, attorney, accountant, or agent, in each case, as necessary or reasonably advisable to verify the accuracy of the information in such registration statement and to conduct appropriate due diligence in connection therewith;

(g) notify each selling Shareholder, promptly after the Company receives notice thereof, of the time when such registration statement has been declared effective or a supplement to any prospectus forming a part of such registration statement has been filed;

(h) after such registration statement becomes effective, notify each selling Shareholder of any request by the SEC that the Company amend or supplement such registration statement or prospectus; and

(i) immediately notify each seller of Registrable Securities and each underwriter under such registration statement, at any time when a prospectus relating thereto is required to be delivered under the Securities Act, of the happening of any event of which the Company has knowledge as a result of which the prospectus contained in such registration statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing, and, at the request of a Majority in Interest, the Company shall promptly prepare a supplement or amendment to such prospectus so that, as thereafter delivered to the purchasers of such Registrable Securities, such prospectus shall not include an untrue statement of a material fact or omit to state any material fact necessary to make the statements therein not misleading; provided that the Company may postpone for up to ninety (90) days the delivery of any such supplement or amendment if the Company's Board of Directors determines in good faith that disclosure of the new information to be contained therein would reasonably be expected to have a material adverse effect on (i) any proposal or plan by the Company or any of its affiliates to engage in any acquisition of assets (other than in the ordinary course of business) or any merger, consolidation, tender offer, reorganization or similar transaction or (ii) any pending or threatened litigation to which the Company is, or is threatened to be made, a party; and

(j) in the case of an underwritten offering, use its best efforts to furnish, at the request of any Shareholder whose Registrable Securities are included in the registration statement, on the date on which such Registrable Securities are sold to the underwriter, (i) an opinion, dated such date, of the counsel representing the Company for the purposes of such registration, in form and substance as is customarily given to underwriters in an underwritten public offering, addressed to the underwriters and such Shareholder and (ii) a comfort letter dated such date, from the independent certified public accountants of the Company, in form and substance as is customarily given by independent certified public accountants to underwriters in an underwritten public offering, addressed to the underwriters, if any.

2.4 **Furnish Information.** It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Section 2 with respect to the Registrable Securities of any selling Shareholder that such Shareholder shall furnish to the

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Company such information regarding such Shareholder, the Registrable Securities held by such Shareholder, and the intended method of disposition of such securities as is reasonably required to effect the registration of such Shareholder's Registrable Securities.

2.5 **Expenses of Registration.** All expenses (other than Selling Expenses) incurred in connection with registrations, filings, or qualifications pursuant to this Section 2, including all registration, filing, and qualification fees, printers' and accounting fees, and fees and disbursements of counsel for the Company, shall be borne and paid by the Company, whether or not any such registration or qualification becomes effective. All Selling Expenses relating to Registrable Securities registered pursuant to this Section 2 shall be borne and paid by the Shareholders pro rata on the basis of the number of Registrable Securities registered on their behalf.

2.6 **Withdrawal of Registration.** The Company shall have the right to terminate or withdraw any registration initiated by it before the effective date thereof, whether or not any Shareholder has elected to include Registrable Securities in such registration, without liability of the Company to any holder of Registrable Securities except for payment of registration expenses as provided in Section 2.5. Any Shareholder may withdraw any Registrable Securities from any registration before the effective date of such registration without liability to the Company or any other holder of Common Stock except for payment of such Shareholder's portion of any Selling Expenses incurred with respect to the period before such withdrawal.

2.7 **Indemnification.** If any Registrable Securities are included in a registration statement under this Section 2:

(a) To the extent permitted by law, the Company will indemnify and hold harmless each selling Shareholder, and the partners, members, officers, directors, and shareholders of each such Shareholder, legal counsel for each such Shareholder, any underwriter (as defined in the Securities Act) for each such Shareholder, and each Person, if any, who controls such Shareholder, underwriter or other Person within the meaning of the Securities Act or the Exchange Act, against any Damages, and the Company will pay to each such Shareholder, underwriter, controlling Person, or other aforementioned Person any legal fees and other expenses reasonably incurred thereby in connection with investigating or defending any claim or proceeding from which Damages may result, as such expenses are incurred; provided, however, that the indemnity agreement contained in this Section 2.7(a) shall not apply to amounts paid in settlement of any such claim or proceeding if such settlement is effected without the consent of the Company, which consent shall not be unreasonably withheld, nor shall the Company be liable for any Damages to the extent that they arise out of or are based upon actions or omissions made in reliance upon and in conformity with written information furnished by or on behalf of any such Shareholder, underwriter, controlling Person, or other aforementioned Person expressly for use in connection with such registration.

(b) To the extent permitted by law, each selling Shareholder, severally and not jointly, will indemnify and hold harmless the Company, and each of its directors, each of its officers who has signed the registration statement, each Person (if any), who controls the Company within the meaning of the Securities Act, legal counsel for the Company, any underwriter (as defined in

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the Securities Act), any other Shareholder selling securities in such registration statement, and any controlling Person of any such underwriter, other Shareholder or other Person, against any Damages, in each case only to the extent that such Damages arise out of or are based upon actions or omissions made in reliance upon and in conformity with written information furnished by or on behalf of such selling Shareholder expressly for use in connection with such registration; and each such selling Shareholder will pay to the Company and each other aforementioned Person any legal fees and other expenses reasonably incurred thereby in connection with investigating or defending any claim or proceeding from which Damages may result, as such expenses are incurred; provided, however, that the indemnity agreement contained in this Section 2.7(b) shall not apply to amounts paid in settlement of any such claim or proceeding if such settlement is effected without the consent of the Shareholder, which consent shall not be unreasonably withheld; and provided further that in no event shall the aggregate amounts payable by any Shareholder by way of indemnity or contribution under Sections 2.7(b) and 2.7(d) exceed the proceeds from the offering received by such Shareholder (net of any Selling Expenses paid by such Shareholder).

(c) Promptly after receipt by an indemnified party under this Section 2.7 of notice of the commencement of any action (including any governmental action) for which a party may be entitled to indemnification hereunder, such indemnified party will, if a claim in respect thereof is to be made against any indemnifying party under this Section 2.7, give the indemnifying party notice of the commencement thereof. The indemnifying party shall have the right to participate in such action and, to the extent the indemnifying party so desires, participate jointly with any other indemnifying party to which notice has been given, and to assume the defense thereof with counsel reasonably mutually satisfactory to the parties; provided, however, that an indemnified party (together with all other indemnified parties that may be represented without conflict by one counsel) shall have the right to retain one separate counsel, with the reasonable fees and expenses to be paid by the indemnifying party, if representation of such indemnified party by the counsel retained by the indemnifying party would be inappropriate due to actual or potential differing interests between such indemnified party and any other party represented by such counsel in such action. The failure to give notice to the indemnifying party within a reasonable time of the commencement of any such action will not relieve such indemnifying party of any liability to the indemnified party under this Section 2.7, except to the extent, and only to the extent, that such failure actually and materially prejudices the indemnifying party's ability to defend such action. The failure to give notice to the indemnifying party will not relieve it of any liability that it may have to any indemnified party otherwise than under this Section 2.7.

(d) To provide for just and equitable contribution to joint liability under the Securities Act in any case in which either (i) any party otherwise entitled to indemnification hereunder makes a claim for indemnification pursuant to this Section 2.7 but it is judicially determined (by the entry of a final judgment or decree by a court of competent jurisdiction and the expiration of time to appeal or the denial of the last right of appeal) that such indemnification may not be enforced in such case, notwithstanding the fact that this Section 2.7 provides for indemnification in such case or (ii) contribution under the Securities Act may be required on the part of any party hereto for which indemnification is provided under this Section 2.7, then, and in each such case, such parties will contribute to the aggregate losses, claims, damages, liabilities, or expenses to which they may be subject (after contribution from

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others) in such proportion as is appropriate to reflect the relative fault of each of the indemnifying party and the indemnified party in connection with the statements, omissions, or other actions that resulted in such loss, claim, damage, liability, or expense, as well as to reflect any other relevant equitable considerations. The relative fault of the indemnifying party and of the indemnified party shall be determined by reference to, among other things, whether the untrue or allegedly untrue statement of a material fact, or the omission or alleged omission of a material fact, relates to information supplied by the indemnifying party or by the indemnified party and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission; provided, however, that, in any such case, no Person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) will be entitled to contribution from any Person who was not guilty of such fraudulent misrepresentation; and provided further that in no event shall the aggregate amounts payable by any Shareholder by way of indemnity or contribution under Sections 2.7(b) and 2.7(d) exceed the proceeds from the offering received by such Shareholder (net of any Selling Expenses) paid by such Shareholder).

(e) Notwithstanding the foregoing, to the extent that any provision on indemnification and contribution contained in the underwriting agreement entered into in connection with the underwritten public offering is in conflict with any of the foregoing provisions, the provision in the underwriting agreement shall control.

(f) The obligations of the Company and Shareholders under this Section 2.7 shall survive the completion of any offering of Registrable Securities in a registration under this Section 2, and otherwise shall survive the termination of this Agreement.

2.8 Limitations on Subsequent Registration Rights. The Company shall not, without the prior written consent of the holders of a majority of the Registrable Securities then outstanding, enter into any agreement that would (x) allow any holder or prospective holder of any securities of the Company to include such securities in any registration under the Securities Act or (y) require the Company to comply with any demand or request by or on behalf of such holder or prospective holder for registration of any securities held by or on behalf of such holder or prospective holder unless (a) such holder or prospective holder is (i) an institutional investor or financial institution that, with the approval of the Board of Directors of the Company, has provided bona fide debt or equity financing to the Company and/or (ii) a holder of Company securities issued with the approval of the Board of Directors of the Company as consideration for the acquisition of a business or assets, and such agreement is entered into as a condition of such financing or acquisition and (b) the terms of such agreement allow the Company to comply with Section 2.1 hereof and require such holder or prospective holder to (i) comply with the underwriting requirements in Section 2.2(a) hereof together with the Shareholders and (ii) include such securities in any such registration only pro rata with the Registrable Securities in compliance with Section 2.2(b) hereof. The Company represents and warrants that no such rights exist as of the date of this Agreement, except as pursuant to this Agreement.

2.9 Termination of Registration Rights. The right of any Shareholder to request inclusion of Registrable Securities in any registration pursuant to Section 2.1 shall terminate on the date that such Shareholder is able to sell, during any three-month period without limitation under Rule 144 of the amount of securities to be sold, all of the remaining Registrable Securities held by or then issuable to such Shareholder.

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3. MISCELLANEOUS.

3.1 **Successors and Assigns.** The rights of a Shareholder under this Agreement may be assigned (but only subject to assumption of all related obligations) by a Shareholder to a transferee of Registrable Securities; provided that the Company is, within a reasonable time after such transfer, furnished with written notice of the name and address of such transferee and the Registrable Securities with respect to which such rights are being transferred and such transferee agrees in a written instrument delivered to the Company to assume and be bound by the terms and conditions of this Agreement as a Shareholder hereunder. The terms and conditions of this Agreement inure to the benefit of and are binding upon the respective heirs, executors, administrators, legal representatives, successors and permitted assignees of the parties. Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and permitted assignees any rights, remedies, obligations or liabilities under or by reason of this Agreement, except as expressly provided herein.

3.2 **Governing Law.** This Agreement (including any claim or controversy arising out of or relating to this Agreement) shall be governed by and construed in accordance with the laws of the State of New York, without regard to conflict of law principles that would result in the application of any law other than the law of the State of New York.

3.3 **Counterparts.** This Agreement may be executed and delivered in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

3.4 **Notices.** All notices and other communications given or made pursuant to this Agreement shall be in writing and shall be deemed effectively given upon the earlier of actual receipt or: (i) when sent, if sent by electronic mail or facsimile during the recipient's normal business hours, and if not sent during normal business hours, then on the recipient's next business day, (ii) five (5) days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (iii) one (1) business day after the business day of deposit with a nationally recognized overnight courier, freight prepaid, specifying next-day delivery. All communications shall be sent to the respective parties at their addresses as set forth on Schedule A hereto, or in the case of the Company, to the principal office of the Company, or to such email address, facsimile number, or address as subsequently modified by written notice given in accordance with this Section 3.4.

3.5 **Amendments and Waivers.** Any term of this Agreement may be amended and the observance of any term of this Agreement may be waived (either generally or in a particular instance, and either retroactively or prospectively) only with the written consent of the Company and the Shareholders holding a majority of the Registrable Securities then held by all Shareholders; provided that any provision hereof may be waived by any waiving party on such party's own behalf, without the consent of any other party. Notwithstanding the foregoing, this Agreement may not be amended or terminated and the observance of any term hereof may not be

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waived with respect to any Shareholder without the written consent of such Shareholder, unless such amendment, termination, or waiver applies to all Shareholders in the same fashion. The Company shall give prompt notice of any amendment or termination hereof or waiver hereunder to any party hereto that did not consent in writing to such amendment, termination, or waiver. Any amendment, termination, or waiver effected in accordance with this Section 3.5 shall be binding on all parties hereto, regardless of whether any such party has consented thereto. No waivers of or exceptions to any term, condition, or provision of this Agreement, in any one or more instances, shall be deemed to be or construed as a further or continuing waiver of any such term, condition, or provision.

3.6 **Severability**. In case any one or more of the provisions contained in this Agreement is for any reason held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality, or unenforceability shall not affect any other provision of this Agreement, and such invalid, illegal, or unenforceable provision shall be reformed and construed so that it will be valid, legal, and enforceable to the maximum extent permitted by law.

3.7 **Entire Agreement**. This Agreement constitutes the full and entire understanding and agreement among the parties with respect to the subject matter hereof, and any other written or oral agreement relating to the subject matter hereof existing between the parties is expressly canceled.

3.8 **Dispute Resolution**. The dispute resolution provisions of the Merger Agreement shall apply to all disputes arising hereunder as if set forth in full herein.

3.9 **Waiver of Jury Trial**. EACH PARTY HEREBY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY RIGHT SUCH PARTY MAY HAVE TO A TRIAL BY JURY IN ANY LEGAL PROCEEDING DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY (WHETHER BASED ON CONTRACT, TORT OR ANY OTHER THEORY). EACH PARTY HEREBY (A) CERTIFIES THAT NO REPRESENTATIVE, AGENT OR ATTORNEY OF ANY OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SUCH OTHER PARTY WOULD NOT, IN THE EVENT OF LITIGATION, SEEK TO ENFORCE THE FOREGOING WAIVER AND (B) ACKNOWLEDGES THAT IT AND THE OTHER PARTIES HAVE BEEN INDUCED TO ENTER INTO THIS AGREEMENT AND THE OTHER TRANSACTION DOCUMENTS BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION 3.9.

3.10 **Delays or Omissions**. No delay or omission to exercise any right, power, or remedy accruing to any party under this Agreement, upon any breach or default of any other party under this Agreement, shall impair any such right, power, or remedy of such nonbreaching or nondefaulting party, nor shall it be construed to be a waiver of or acquiescence to any such breach or default, or to any similar breach or default thereafter occurring, nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring. All remedies, whether under this Agreement or by law or otherwise afforded to any party, shall be cumulative and not alternative.

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IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

E COM VENTURES, INC.

By:
Name:
Title:

SHAREHOLDERS:

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Exhibit B

SCHEDULE A

SHAREHOLDERS

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EXHIBIT C

Affiliate Debt

Maturity date: three years following the Closing Date

Interest rate: Either 4.75% over LIBOR or 3.75% over the prime rate as published in the Eastern Edition of the Wall Street Journal at E Com s election

Subordinated to senior creditor financings, including the financing pursuant to the Commitment Letter

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AMENDMENT TO AGREEMENT AND PLAN OF MERGER

This AMENDMENT, dated July 8, 2008 (this Amendment), to the AGREEMENT AND PLAN OF MERGER, dated as of December 21, 2007 (the Original Agreement), is made and entered into by and among Model Reorg, Inc., a New York corporation (Model), E Com Ventures, Inc., a Florida corporation (E Com), Model Reorg Acquisition LLC, a Delaware limited liability company and wholly-owned subsidiary of E Com (Acquisition Sub), and the shareholders of Model who are signatories thereto and hereto. Capitalized terms used in this Amendment and not otherwise defined herein shall have the meanings ascribed to such terms in the Original Agreement.

RECITALS

WHEREAS, Section 9.2 (Amendment or Supplement) of the Original Agreement provides that, at any time prior to the Effective Time, the Original Agreement may be amended in any and all respects by written agreement of the parties thereto, and by action taken by the respective Boards of Directors of E Com and Model;

NOW, THEREFORE, in consideration of the foregoing recital and the agreements herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto hereby agree that the Original Agreement shall be amended as follows:

1. The definition of Agreement in the preamble to the Original Agreement shall be deleted in its entirety and replaced by the following:

(together with the Exhibits and Schedules thereto, as the foregoing may be supplemented, modified, amended, restated or extended from time to time in the manner provided therein, this Agreement)

2. The definition of Affiliate Consignment in Section 9.11 (Definitions; Construction) of the Original Agreement shall be deleted in its entirety and all references to Affiliate Consignment throughout the Original Agreement shall be deleted from the Original Agreement as set forth below:

(a) Section 4.21 (Related Person Transactions) to the Original Agreement shall be amended to remove and for the Affiliate Consignment as an exception from the first sentence of Section 4.21; and

(b) Section 5.1(a)(iii) (Conduct of Business) to the Original Agreement shall be amended to remove or the Affiliate Consignment as an exception.

3. The definition of Affiliate Debt in Section 9.11 (Definitions; Construction) of the Original Agreement shall be deleted in its entirety and replaced by the following:

Affiliate Debt means the subordinated debt payable by Model to (i) certain Model Shareholders or trusts for the benefit of their family members in the amount and on the terms and conditions substantially similar to those described on

Exhibit C attached hereto and such other terms as shall be mutually agreeable to such Model Shareholders and E Com and (ii) Quality King Distributors, Inc. that remains outstanding after the consummation of the QKD Debt Restructuring in the amount and on the terms and conditions substantially similar to those described on Exhibit C attached hereto and such other terms as shall be mutually agreeable to Quality King Distributors, Inc., Model and E Com.

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4. Exhibit C (Affiliate Debt) to the Original Agreement shall be deleted in its entirety and replaced by Exhibit C attached hereto.

5. The definition of Commitment Letter in Section 9.11 (Definitions; Construction) of the Original Agreement shall be deleted in its entirety and replaced by the following:

Commitment Letter shall mean the commitment letter previously provided to the Board of Directors of E Com dated May 16, 2008 between a senior lender and E Com, as the same may be supplemented, modified, amended, restated or extended from time to time.

6. A new definition shall be added to Section 9.11 (Definitions; Construction) of the Original Agreement and shall read as follows:

OKD Debt Restructuring means the restructuring of the debt payable by Model to Quality King Distributors, Inc. in the amount and on the terms and conditions substantially similar to those described on Exhibit C attached hereto and such other terms as shall be mutually agreeable to Quality King Distributors, Inc., Model and E Com.

7. Section 4.5(a) (Undisclosed Liabilities, Etc.) of the Original Agreement shall be deleted in its entirety and replaced by the following:

(a) The audited consolidated financial statements of Model as of and for the years ended October 31, 2004, 2005, 2006, and 2007, and unaudited consolidated financial statements of Model as of and for the eleven months ended September 30, 2007 (the Model Financial Statements), and all subsequent interim financial statements provided by Model in accordance with Section 5.8(i) before the Closing Date, have been prepared in accordance with GAAP, and fairly present in all material respects the consolidated financial position of Model and its consolidated Subsidiaries as of the dates thereof and the consolidated results of their operations and cash flows for the periods then ended (subject, in the case of unaudited quarterly statements, to normal year-end audit adjustments).

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8. Section 6.1(d) (Conditions to Each Party's Obligation to Effect the Merger) of the Original Agreement shall be deleted in its entirety and replaced by the following:

(d) Asset based loans in the amount and on terms substantially similar to those contemplated in the Commitment Letter shall have been obtained by Acquisition Sub and/or E Com and funds shall have been advanced and/or be available thereunder;

9. Section 6.1(f) (Conditions to Each Party's Obligation to Effect the Merger) shall be amended to read in its entirety as follows:

(f) The transactions described in the definition of Affiliate Debt shall have been put in place, including, without limitation, the QKD Debt Restructuring, on or prior to the Closing.

10. Section 6.3(d) (Conditions to E Com's and Acquisition Sub's Obligations to Effect the Merger) shall be deleted in its entirety and replaced by the following:

(d) Each of Model and Quality King Distributors, Inc. shall have executed and delivered a services agreement in a form that is mutually agreeable to Quality King Distributors, Inc., Model and E Com;

11. Section 6.3(e) (Conditions to E Com's and Acquisition Sub's Obligations to Effect the Merger) shall be deleted in its entirety.

12. Section 6.3(g) (Conditions to E Com's and Acquisition Sub's Obligations to Effect the Merger) shall be renumbered as Section 6.3(e) and all references to Section 6.3(g) in the Original Agreement shall refer to Section 6.3(e);

13. The definition of Outside Date in Section 7.1(c)(i) (Termination) shall be amended to be August 31, 2008.

14. The address of Model for notice purposes in Section 9.8 (Notices) shall be deleted in its entirety and replaced by the following:

Model Reorg, Inc.

35 Sawgrass Drive, Suite 2

Bellport, NY 11713

Attention: Michael Katz

Facsimile No.: (631) 866-4231

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15. The address of Seller Representative for notice purposes in Section 9.8 (Notices) shall be deleted in its entirety and replaced by the following:

Stephen Nussdorf

c/o Model Reorg, Inc.

35 Sawgrass Drive, Suite 2

Bellport, NY 11713

Facsimile No.: 631-866-4109

16. By his, her or its execution hereof, each of the Model Shareholders hereby consents to this Amendment.

17. Except as expressly provided in this Amendment, the Original Agreement is, and shall continue to be, in full force and effect in accordance with its terms, without amendment thereto, and is, in all respects, ratified and confirmed.

18. This Amendment shall be subject to the provisions set forth in Article 9 (Miscellaneous) of the Original Agreement, which are incorporated herein by this reference with the same force and effect as if set forth herein.

The remainder of this page left blank.

[Signature page follows]

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IN WITNESS WHEREOF, in accordance with Section 9.2 (Amendment or Supplement) of the Original Agreement, the parties hereto have caused this Amendment to be duly executed, as of the date first above written.

MODEL REORG, INC.

By: /s/ Michael W. Katz
Michael W. Katz
Chief Executive Officer

E COM VENTURES, INC.

By: /s/ Donovan Chin
Donovan Chin
Chief Financial Officer and Secretary

MODEL REORG ACQUISITION LLC

By E Com Ventures, Inc., its sole member

By: /s/ Donovan Chin
Donovan Chin
Chief Financial Officer and Secretary

[Model Shareholder Signatures Follow]

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The undersigned, Model Shareholders, acknowledging the terms and provisions of this Amendment, have executed this Amendment as of the date first above written.

/s/ Glenn Nussdorf
Glenn Nussdorf

/s/ Stephen Nussdorf
Stephen Nussdorf

/s/ Arlene Nussdorf
Arlene Nussdorf

/s/ Rene Garcia
Rene Garcia

THE JACQUELINE MARIE GARCIA 2006

FAMILY TRUST u/t/a dated October 30, 2006

By /s/ Rene A. Garcia, Trustee
RENE A. GARCIA, Trustee

By: /s/ Rafael Villoldo, Trustee
RAFAEL VILLOLDO, Trustee

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THE CAROLINA MARIE GARCIA 2006

FAMILY TRUST u/t/a dated October 30, 2006

By: /s/ Rene A. Garcia, Trustee
RENE A. GARCIA, Trustee

By /s/ Rafael Villoldo, Trustee
RAFAEL VILLOLDO, Trustee

IRREVOCABLE TRUST FOR VICTOR GARCIA

u/t/a dated October 30, 2006

By: /s/ Rene A. Garcia, Trustee
RENE A. GARCIA, Trustee

By: /s/ Rafael Villoldo, Trustee
RAFAEL VILLOLDO, Trustee

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EXHIBIT C

Affiliate Debt

Total Affiliate Debt - Amount: Approximately \$87.3 million after giving effect to the transactions described in this Exhibit C

(a) Subordinated Debt Payable by Model to Certain Model Shareholders

Amount: \$52.3 million

Maturity date: At least 6 months beyond the scheduled maturity date of the senior creditor financing described in the Commitment Letter

Amortization: Bullet at maturity

Interest rate: 2% per annum over the rate applicable from time to time to the revolving credit facility described in the Commitment Letter payable quarterly

Security: Unsecured

Priority: Subordinated to institutional creditor financings, including the financing pursuant to the Commitment Letter

Use of Proceeds: (i) Working capital and (ii) payment of all but \$35 million of the subordinated debt owed by Model to Quality King Distributors, Inc.

(b) Restructured Subordinated Debt Payable to Quality King Distributors, Inc. after the Payment described in Clause (a) of this Exhibit C

Amount: \$35.0 million

Maturity Date: June 30, 2012

Amortization: Quarterly amortization of \$2.5 million, commencing January 2009, and a final balloon payment 6 months following the scheduled maturity of the senior creditor financing described in the Commitment Letter

Interest rate: 1% per annum over the rate applicable from time to time to the revolving credit facility described in the Commitment Letter

Security: Unsecured

Priority: Subordinated to institutional creditor financings, including the financing pursuant to the Commitment Letter

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Annex II Financo Opinion

Letterhead of Financo, Inc.

December 21, 2007

PERSONAL & CONFIDENTIAL

Special Committee of the Board of Directors

E Com Ventures, Inc.

251 International Parkway

Sunrise, FL 33325

Members of the Special Committee:

We understand that E Com Ventures, Inc. (the Company), Model Reorg Acquisition LLC (Acquisition Sub), Model Reorg, Inc. (Model) and the holders of the outstanding capital stock of Model propose to enter into an Agreement and Plan of Merger, substantially in the form of the draft dated December 20, 2007 (the Agreement), which provides, among other things, that (i) Model will merge with and into Acquisition Sub (the Merger) and (ii) all issued and outstanding shares of common stock, no par value, of Model (Model Common Stock), other than shares of Model Common Stock held in the treasury of Model, will be converted into the right to receive 5,900,000 shares (the Shares) of common stock, par value \$0.01 per share, of the Company (Company Common Stock), and warrants (the Warrants), and together with the Shares, the Merger Consideration) to purchase 1,500,000 shares of Company Common Stock.

The Special Committee of the Board of Directors of the Company (the Special Committee) has requested our opinion as to the fairness of the Merger Consideration, from a financial point of view, to holders of Company Common Stock (other than those who own, or whose affiliates own, securities of Model).

Financo, Inc. provides merger and acquisition advisory services to public and private companies. In this capacity, we are continually engaged in performing financial analyses with respect to businesses and their securities in connection with mergers and acquisitions as well as for other transactions and corporate purposes.

In connection with rendering our opinion, we have reviewed and considered such financial and other matters as we have deemed relevant, including, among other things:

- a. drafts of the Agreement, the Warrants and a registration rights agreement, each dated December 20, 2007 which, for purposes of this opinion, we have assumed to be in all material respects identical to the forms of such agreements to be executed;
- b. certain publicly available financial and other information for the Company, including its Annual Report on Form 10-K for the fiscal year ended January 31, 2007 and Quarterly Reports on Form 10-Q for the quarters ended April 30 and July 31, 2007, and certain other relevant financial and operating data furnished to us by management of the Company;
- c. historical financial information of Model, prepared and furnished to Financo by management of Model;

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- d. certain internal financial analyses, financial forecasts, reports and other information concerning the Company, prepared and furnished to us by management of the Company and management and representatives of Model;
- e. certain internal financial analyses, financial forecasts and other information concerning Model, furnished to us by management and representatives of Model;
- f. discussions we have had with certain members of Company management concerning the historical and current business operations and strategy, financial condition and prospects of the Company and such other matters as we deemed relevant;
- g. discussions we have had with certain members of Model management concerning the historical and current business operations and strategy, financial condition and prospects of Model and such other matters as we deemed relevant;
- h. certain operating results, the reported prices and historical trading activity of Company Common Stock, and the operating results, reported prices and historical trading activity of the securities of certain publicly traded companies we deemed relevant;
- i. certain financial terms of the Merger as compared to the financial terms of certain selected business combinations we deemed relevant; and
- j. such other information, financial studies, analyses and investigations and such other factors that we deemed relevant for the purposes of this opinion.

In conducting our review and arriving at our opinion, we have, with your consent, assumed and relied, without independent investigation, upon the accuracy and completeness of the information publicly available about the Company and Model, and the financial and other information provided to us or otherwise made available to, discussed with, or reviewed by or for us. We have not assumed any responsibility for the accuracy or completeness, or independently verified, any such information and we have relied on the assurance provided by Company management that they are unaware of any facts that would make such information incomplete or misleading. With respect to the transaction process conducted on behalf of the Company, we have assumed and relied upon, without assuming any responsibility for independent verification of, the accuracy and completeness of the information supplied, summarized or otherwise made available to, discussed with, or reviewed by or for us, including as to the completeness of the process. Our analyses were based, among other things, on the financial projections of the Company (the Company Financial Projections) prepared by management of the Company and the financial projections of Model prepared by management of Model (the Model Financial Projections) and collectively with the Company Financial Projections, the Financial Projections). With respect to the Financial Projections, which were furnished to us, discussed with us or reviewed for us by management of the Company or Model, as the case may be, we have assumed that they have been reasonably prepared on bases reflecting the best currently available estimates and good faith judgments of management of the Company or Model, as the case may be, as to the future competitive, operating and regulatory environments and related financial performance of the Company or Model, as the case may be, and such projections and the assumptions derived therefrom provide a reasonable basis for our opinion. We express no view as to such Financial Projections, or the assumptions on which they are based.

For purposes of rendering our opinion we have assumed in all respects material to our analysis that the representations and warranties of each party contained in the Agreement are true and correct, that each party will perform all of the covenants and agreements required to be performed by it under the Agreement and that all conditions to the consummation of the Merger will be satisfied without waiver or modification thereof. We have also assumed that in the course of obtaining the necessary regulatory and third party

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approvals, consents and releases for the Merger, no modification, delay, restriction or condition will be imposed that will have a material adverse effect on the Merger and that the Merger will be consummated in accordance with applicable laws and regulations and the terms of the Agreement, without delay, waiver, amendment or modification of any material term, condition or agreement. We have relied without independent verification upon the views of management of the Company concerning the business, operational and strategic benefits and implications of the Merger. We do not express any view on, and this opinion does not address, the fairness of the amount or nature of any compensation to be paid or payable to any of the officers, directors or employees of the Company or Model, or any class of such persons, whether relative to the Merger Consideration or otherwise.

Our analyses must be considered as a whole. Considering any portion of such analyses or the factors considered, without considering all analyses and factors, could create a misleading or incomplete view of the process underlying the conclusions expressed herein.

We have not been asked to pass upon, and express no opinion with respect to, any matters, including any agreements between the Company and Model or any of their respective affiliates, other than the fairness from a financial point of view of the Merger Consideration to holders of Company Common Stock (other than those who own, or whose affiliates own, securities of Model). In connection with our engagement, we have not evaluated nor did the Special Committee or the Company request us to evaluate, alternative transaction structures or financial alternatives other than the Merger and we did not otherwise participate in the transaction process. Our opinion does not address the Company's underlying business decision to effect the Merger.

We have not made or obtained any independent evaluations, valuations or appraisals of the assets or liabilities of the Company or Model nor have we been furnished with such materials. In addition, we have not conducted, nor have we assumed any obligation to conduct, any physical inspection of the properties or facilities of the Company or Model. We have assumed with your consent that there are no legal issues with regard to the Company or Model that would affect our opinion, and we have relied on this assumption without undertaking any independent investigation or inquiry. Our opinion is necessarily based upon economic and market conditions and other circumstances as they exist and can be evaluated by us on the date hereof. It should be understood that although subsequent developments may affect our opinion, we do not have any obligation to update, revise or reaffirm our opinion and we expressly disclaim any responsibility to do so. Our opinion does not address the relative merits of the Merger as compared to other business strategies that might be available to the Company, nor does it address the underlying business decision of the Company to proceed with the Merger. We express no view as to the federal, state or local tax consequences of the Merger. This opinion has been approved by a Fairness Committee of Financo.

It is understood that this letter is intended for the benefit and use of the Special Committee in its consideration of the Merger and may not be used for any other purpose or reproduced, disseminated, quoted, communicated (in whole or in part) or referred to at any time, in any manner or for any purpose without our prior written consent, except that this opinion may be included in its entirety, if required, in any filing made by the Company with respect to the Merger with the Securities and Exchange Commission, provided that this opinion is reproduced in such filing in full and any description of or reference to us or summary of this opinion and the related analyses in such filing is in a form acceptable to us and our counsel in our sole discretion. This letter does not constitute a recommendation to any holder of Company Common Stock, or any other person, as to how such person should act with respect to the Merger.

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We have been retained to represent the Special Committee of the Board of Directors of the Company to give an opinion as to the fairness of the Merger Consideration, from a financial point of view, to the holders of Company Common Stock (other than those who own, or whose affiliates own, securities of Model). We have received an initial fee in connection with our services and an additional fee upon our advising the Special Committee that we were prepared to deliver this opinion. No portion of our fee is contingent upon the consummation of the Merger.

Based upon and subject to the foregoing, including the various assumptions and limitations set forth herein, it is our opinion that, as of the date hereof, the Merger Consideration is fair, from a financial point of view, to holders of Company Common Stock (other than those who own, or whose affiliates own, securities of Model).

Very truly yours,

FINANCO, INC.

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Annex III- Certificate of Amendment to Articles of Incorporation to Increase Number of Authorized Shares

ARTICLES OF AMENDMENT TO THE
AMENDED AND RESTATED ARTICLES OF INCORPORATION
OF
E COM VENTURES, INC.
a Florida corporation

Pursuant to the provisions of Section 607.1006 of the Florida Business Corporation Act, the Amended and Restated Articles of Incorporation of E Com Ventures, Inc. (the Corporation) are hereby amended as follows:

1. Article III of the Amended and Restated Articles of Incorporation is hereby amended to provide the following:

The aggregate number of shares of all classes of capital stock that the Corporation shall have authority to issue is twenty-one million (21,000,000) shares, consisting of (i) twenty million (20,000,000) shares of common stock, par value \$0.01 per share (the Common Stock), and (ii) one million (1,000,000) shares of preferred stock, par value \$0.01 per share (the Preferred Stock).

Except as hereby amended, the Amended and Restated Articles of Incorporation of the Corporation shall remain the same.

2. The foregoing amendment to the Amended and Restated Articles of Incorporation of the Corporation was recommended by the Board of Directors of the Corporation and submitted to the shareholders of the Corporation for approval at the special meeting of the shareholders of the Corporation, held on _____, 2008. The amendment to the Amended and Restated Articles of Incorporation of the Corporation was approved by the shareholders of the Corporation, with the number of votes cast for the amendment being sufficient for approval in accordance with the applicable provisions of the Florida Business Corporation Act.

IN WITNESS WHEREOF, the undersigned duly authorized officer of the Corporation has executed these Articles of Amendment to the Amended and Restated Articles of Incorporation as of this __ day of _____, 2008.

[Name]
[Title]

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Annex IV- Certificate of Amendment to Articles of Incorporation to Effect Name Change

ARTICLES OF AMENDMENT TO THE
AMENDED AND RESTATED ARTICLES OF INCORPORATION
OF
E COM VENTURES, INC.
a Florida corporation

Pursuant to the provisions of Section 607.1006 of the Florida Business Corporation Act, the Amended and Restated Articles of Incorporation of E Com Ventures, Inc. (the Corporation) are hereby amended as follows:

1. Article I of the Amended and Restated Articles of Incorporation of the Corporation is hereby deleted in its entirety and replaced with the following:

The name of the Corporation is Perfumania Holdings, Inc.

2. The foregoing amendment to the Amended and Restated Articles of Incorporation of the Corporation was recommended by the Board of Directors of the Corporation and submitted to the shareholders of the Corporation for approval at the special meeting of the shareholders of the Corporation, held on _____, 2008. The amendment to the Amended and Restated Articles of Incorporation of the Corporation was approved by the shareholders of the Corporation, with the number of votes cast for the amendment being sufficient for approval in accordance with the applicable provisions of the Florida Business Corporation Act.

IN WITNESS WHEREOF, the undersigned duly authorized officer of the Corporation has executed these Articles of Amendment to the Amended and Restated Articles of Incorporation as of this __ day of _____, 2008.

[Name]
[Title]

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FORM OF E COM VENTURES PROXY CARD

qFOLD AND DETACH HERE AND READ THE REVERSE SIDEq

E COM VENTURES, INC.

251 International Parkway

Sunrise, Florida 33325

PROXY FOR SPECIAL MEETING OF SHAREHOLDERS

THIS PROXY IS SOLICITED ON BEHALF OF THE COMPANY S BOARD OF DIRECTORS

The undersigned holder of common stock of E Com Ventures, Inc., a Florida corporation (the Company), hereby appoints Donovan Chin and Joseph Bouhadana, as proxies for the undersigned, each with full power of substitution, for and in the name of the undersigned to act for the undersigned and to vote, as designated on the reverse side of this proxy card, all of the shares of stock of the Company held of record by the undersigned at the close of business on [], 2008 at the Company s Special Meeting of Shareholders to be held on [], at [] a.m. at [], and at any postponements or adjournments thereof.

(PLEASE SIGN ON REVERSE SIDE)

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qFOLD AND DETACH HERE AND READ THE REVERSE SIDEq

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR PROPOSALS 1-4

1. To approve the issuance of shares of common stock and Warrants under the Agreement and Plan of Merger dated as of December 21, 2007, by and among E Com Ventures, Inc., Model Reorg, Inc., the shareholders of Model Reorg, and Model Reorg Acquisition LLC, as amended, and the issuance of common stock upon exercise of the Warrants.

FOR " AGAINST " ABSTAIN "

2. To amend E Com Ventures Articles of Incorporation to increase the number of authorized shares of common stock from 6,250,000 shares to 20,000,000 shares.

FOR " AGAINST " ABSTAIN "

3. To amend E Com Ventures Articles of Incorporation to change the company s name to Perfumania Holdings, Inc.

FOR " AGAINST " ABSTAIN "

4. To postpone or adjourn, if necessary, the Special Meeting to a later time to solicit additional proxies in favor of Proposals 1, 2 or 3.

FOR " AGAINST " ABSTAIN "

5. In their discretion, upon such other business as may properly come before the Special Meeting or any postponement or adjournment thereof.

THIS PROXY, WHEN PROPERLY EXECUTED, WILL BE VOTED IN THE MANNER DIRECTED
HEREIN BY THE UNDERSIGNED SHAREHOLDER. IF NO DIRECTION IS MADE, THIS PROXY
WILL BE VOTED FOR EACH PROPOSAL.

PLEASE MARK, SIGN AND DATE THIS PROXY CARD AND PROMPTLY RETURN IT IN THE
ENVELOPE PROVIDED.

DATE _____

SIGNATURE _____

SIGNATURE (If held jointly) _____

Note: Please sign exactly as your name appears hereon and mail it promptly even though you may plan to attend the Special Meeting. When shares are held by joint tenants, both should sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title. If a corporation, please sign in full corporate name by president or other authorized officer. If partnership, please sign in the partnership name by authorized person.