



FORTUNECITY.COM INC. - 2006 ANNUAL REPORT



March 30, 2007

Dear Fellow Shareholders,

The sale of our paid web hosting business and the German subsidiary early in the year paved the way for FortuneCity to focus on its online advertising and photo service businesses in North America. While these transactions resulted in a decrease of revenue to \$2.039 million, MyPhotoAlbum's revenue grew by 266% and the gross margin on advertising sales expanded to 78%.

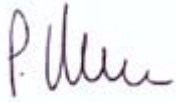
The revenue growth of MyPhotoAlbum.com was driven by a variety of new features and product offerings combined with an increase in registrations. MyPhotoAlbum's active user base expanded 43% to over 250,000 active users at year end that uploaded more than 35 million photos. The user base growth continued to be driven organically with nominal advertising expenditure, 50% of new registrations generated from visitors viewing another MyPhotoAlbum account. A multitude of product enhancements were launched over the course of the year including the video sharing service, Web 2.0 sharing features, membership loyalty points program, photo editor, drag and drop personalization builder, and a user profile page.

The photo service now has four distinct revenue streams: advertising, photo prints and cards, photo gift merchandise, and the premium subscription service. Advertisements are displayed on all non-subscription page views. A variety of photo gift products were launched in 2006 ranging from mouse pads and mugs to personalized photo calendars. And MyPhotoAlbum's premium paid subscription base grew to 6,500 users, representing 2.5% of all active users even after an annual rate increase was implemented early in the year. The Company believes that over time subscriptions to its Club Membership service will become core to the business model. Club member accounts are free of advertising and are provided a wider choice of online photo album build tools as well as discounts on prints. The Company plans to implement another price increase this year and expects the percentage of paid subscribers will continue its strong growth.

The online advertising sales effort was streamlined by reducing personnel, and partnering with a fewer number of clients and external sales networks. In the latter part of the year we experienced encouraging results as seen in the expanded gross margins. By partnering with companies such as Google, we are able to leverage their massive sales distribution and technological strengths to populate our page views with higher paying and more relevant advertising. In the second quarter, the Company entered into an equity unit purchase agreement with a group

of new investors raising net cash proceeds of \$605,000 and adding strategic management and transactional skills to the Company. Through leveraged financing efforts, FortuneCity will seek to identify and acquire businesses well suited to exploit the Company's new media strengths.

Yours truly,

A handwritten signature in dark ink, appearing to read "P. Macnee", written in a cursive style.

*Peter Macnee
President and CEO*

A handwritten signature in dark ink, appearing to read "J. Metcalfe", written in a cursive style.

*Jeremy W. Metcalfe
Chairman of the Board*

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Overview

FortuneCity.com Inc. and its subsidiaries ("FortuneCity" or the "Company") provide online web services and interactive media sales. The services are marketed through uniquely branded websites targeting small businesses and individuals based primarily in North America.

The Company continues to offer its original advertising supported free homepage service under the FortuneCity.com brand and the free sub-domain redirect engine under the V3.com brand. Over the past two years, the Company internally developed MyPhotoAlbum, a personalized online photo and video sharing service. FortuneCity also controls HotGames.com, an online games community featuring a wide range of game downloads. The Company's interactive media sales agency sells the Company's significant online advertising impressions generated on FortuneCity's web properties that can be located at:

www.FortuneCity.com
www.MyPhotoAlbum.com
www.V3.com
www.HotGames.com

The Company offers free trial web services across all of its brands as an efficient customer acquisition strategy. All free basic web services produce revenue through the sale of advertising campaigns on the Internet traffic generated by its customers and others viewing the web pages. Users are continually marketed the Company's premium subscription based service packages to eliminate advertising and gain preferred service features.

Revenue Sources

Media Sales. The Company's advertising revenues are derived by delivering advertising impressions on the Company's web sites and on third party web sites. An "impression" is deemed delivered when an advertisement appears on a web page viewed by the web site visitor. The duration of the Company's advertising commitments typically range from one week to one month. Advertising revenue is recorded net of agency fees and third party publisher payments.

Web Services. Prior to January 31, 2006, the Company earned revenues from the paid web hosting subscription fees billed monthly, quarterly or annually. The fees the Company charged for web hosting services differed based on the type of hosting plan purchased and the amount of data storage, bandwidth and other services included. Revenue from paid web hosting was recognized over the life of the service contract. Domain name registration revenue consists of domain name registrations, renewals and transfers and was recorded net of the fees paid to register the domains. On January 31, 2006, the Company sold its web hosting customer base, and accordingly generated only one month of web hosting and domain registration revenue for the year ended December 31, 2006.

Marketing and Licensing. On January 31, 2006, simultaneous with the sale of the web hosting customer base, the Company entered into an exclusive marketing and licensing agreement for paid web hosting services. The Company leverages the traffic and goodwill associated with its web hosting brand name and website in return for a 57.5% share of new customer's revenue during the first year of service.

Photo Services. The Company generates revenues from the printing and shipping of photo prints, photo cards and calendars, photo gift merchandise such as mugs, mouse pads and shirts, annual memberships to the premium club service, and account reactivation fees. Revenues are recorded net of returns, promotions

redeemed by customers and other discounts. Customers can place orders via our website only and pay primarily using credit cards.

2006 Performance Highlights

- **First Time Full Year Positive Net Income Recorded** – The Company recorded net income for the year ended December 31, 2006 of \$280,994. This positive net income was driven by the gain on the sale of the Company's paid web hosting customer base and gain on the sale of the German subsidiary.
- **Photo Services Revenue Increased by 266%** – The Company experienced consistent growth in photo services revenue as a result of increased sales of print products as well as the introduction of photo merchandise. Additionally, the Company continued to see positive growth in the percentage of free members upgrading to the paid Club membership program.
- **Sold Paid Web Hosting Customer Base** – In January 2006, the Company made the strategic decision to sell its paid web hosting and domain name customer base to Hostopia Inc. for a total consideration of \$1,132,000. The Company received an initial 20% payment at closing followed by monthly installments equal to 50% of the revenue collected from continuing customers, less a monthly portion attributed to deferred revenue and an outstanding payable to Hostopia, until the purchase price is paid in full.
- **Sold German Subsidiary** – In March 2006, the Company sold Ampira GmbH, its wholly owned German subsidiary, to KON AG Klinkhammer Online for \$244,000 as part of its continued effort to focus its business activities on the North American market. KON paid an advance of \$12,000 upon signing of the term sheet, \$177,000 at closing, with the remainder (\$55,000) being paid in ten equal monthly installments starting 30 days after closing.
- **Completed Equity Unit Purchase Agreement** – In May 2006, the Company entered into an equity unit purchase agreement with a group of new investors raising net proceeds of \$605,332 and adding strategic management and transactional skills to the Company.

Results of Operations

Revenues

Revenues for 2006 and 2005 primarily consisted of Media Sales, which represented 79% and 65% of total revenues, respectively. The table below contains a revenue breakdown by source for the years ended December 31, 2006 and 2005:

	<u>For the Year Ended December 31, 2006</u>	<u>For the Year Ended December 31, 2005</u>
Media Sales	\$ 1,612,581	\$ 1,930,125
Web Services	57,862	973,832
Marketing and Licensing Revenue	96,707	-
Photo Services	<u>271,532</u>	<u>74,249</u>
Total revenues.....	<u><u>\$ 2,038,682</u></u>	<u><u>\$ 2,978,206</u></u>

Revenue for the year ended December 31, 2006 decreased 32% over the same period in 2005 to \$2,038,682 from \$2,978,206. This was due to sale of the paid web hosting customer base resulting in a decrease of 84% from web services. Media sales also decreased due to the decline in sales of advertising to third party publishers. These decreases were partially offset by the substantial growth in the photo services revenue,

which grew 266% from 2005 to 2006. Additionally, the decline in web services revenue was offset by the introduction of revenue from the marketing and licensing agreement that was entered into at the same time as the sale of the web hosting customer base.

Costs and Expenses

The following table highlights the costs and expenses for the years ended December 31, 2006 and 2005.

	For the Year Ended December 31, 2006	% of Revenues	For the Year Ended December 31, 2005	% of Revenues
Total revenues	\$ 2,038,682	100%	\$ 2,978,206	100%
Costs and expenses:				
Costs of revenues	834,384	41%	1,418,031	48%
Sales and marketing	428,469	21%	709,516	24%
Product development	659,887	32%	646,233	22%
General and administrative	513,732	25%	790,069	27%
Total costs and expenses	\$ 2,436,472	120%	\$ 3,563,849	120%

Costs of Revenues

The principal expenses included in cost of revenues are data center service charges, cost of bandwidth, costs of serving online advertisements and payroll related costs.

The cost of revenues for the year ended December 31, 2006 decreased 41% from \$1,418,031 to \$834,384, over the similar period in 2005, and decreased as a percentage of total revenues from 48% to 41%. The decrease in cost of revenues for the year ended December 31, 2006 was predominately attributable to the cancellation of a Strategic Services Agreement with Hostopia.com Inc. to provide private labeled web hosting solution as a result of the sale of the paid web hosting customer base.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries and related benefits, advertising, promotions and public relations.

The sales and marketing expenses for the year ended December 31, 2006 decreased from \$709,516 to \$428,469, or 40%, over the similar period in 2005 and decreased as a percentage of total revenues from 24% to 21%. The decrease in sales and marketing expenses for the year 2006 was primarily attributable to a 55% reduction in payroll and related expenses. This decrease in payroll and related expenses was directly related to the Company no longer needing the sales team associated with the paid web hosting business after the sale of the paid web hosting customer base on January 31, 2006.

Product Development

Product development expenses include salaries and related costs associated with software development, testing and upgrading of the Company's network of web sites.

The product development expenses for the year ended December 31, 2006 remained flat, increasing from \$646,233 to \$659,887, or 2%, over the similar period in 2005 and increased as a percentage of total revenues from 22% to 32%.

General and Administrative

General and administrative expenses include employee salaries and related costs, rent, professional services, non-cash benefit related to stock options and other corporate expenses.

The general and administrative expenses for the year ended December 31, 2006 decreased from \$790,069 to \$513,732, or 35%, over the similar period in 2005 and decreased as a percentage of total revenues from 27% to 25%. The decrease in general and administrative expenses for the year 2006 was attributable to the sublease of the Company's office space, refund of Franchise Tax and various other corporate expenses.

Discontinued Operations

In December 2005, the Company decided to discontinue the operations of its Hamburg, Germany based online media sales subsidiary, Ampira GmbH ("Ampira"). Ampira's sales, reported in discontinued operations, for the years ended December 31, 2006 and December 31, 2005, were \$152,256 and \$816,276, respectively. Ampira's net income, reported in discontinued operations, for the years ended December 31, 2006 and 2005, was \$5,502 and \$119,707, respectively. The sale was finalized on March 24, 2006.

Gain on Sale of Asset

On January 31, 2006, the Company sold its paid web hosting assets to Hostopia.com Inc. ("Hostopia") for a contingent purchase price of \$1,132,000. At the time of the sale, the Company had outstanding liabilities to Hostopia totaling \$432,000. Hostopia is offsetting liabilities outstanding against the purchase price resulting in potential cash proceeds of \$700,000. The Company received an initial 20% payment at closing followed by monthly installments equal to 50% of the revenue collected from continuing customers. For the year ended December 31, 2006, a gain on sale of asset of \$464,785 was recorded, which was the net consideration received minus related fees and expenses.

Gain on Sale of Subsidiary

On March 24, 2006, the Company completed the sale of the stock of Ampira. A gain of \$218,086 was recorded in the consolidated statements of operations for the year ended December 31, 2006.

Liquidity and Capital Resources

The Company has incurred net losses and negative cash flows from operations since inception. The Company's ability to maintain its operations in the ordinary course of business is dependent on its ability to grow the online media sales business, to increase the number of club memberships and digital prints sold through its online photo sharing service and to seamlessly refer prospective paid web hosting customers under the web hosting marketing and licensing agreement with Hostopia. However, there is no assurance that the Company will be able to achieve its growth objectives.

The Company has primarily funded its losses to date with the proceeds of its March 1999 initial public offering, which raised approximately \$87,000,000.

As of December 31, 2006 the Company had approximately \$402,000 in cash, cash equivalents and short-term investments.

On January 31, 2006, the Company sold its paid web hosting assets to Hostopia for a contingent purchase price of \$1,132,000, less total liabilities of \$432,000, this results in potential cash proceeds of \$700,000. For the year ended December 31, 2006, the Company received net cash consideration of \$282,522 in connection with this sale.

On March 22, 2006, the Company sold the stock of Ampira GmbH for approximately \$244,000 resulting in net cash proceeds of approximately \$199,000 received during the year ended December 31, 2006. The final installment payment of approximately \$5,000 was received in February 2007.

In May 2006, the Company entered into an equity unit purchase agreement with a group of new investors raising net proceeds of \$605,332 and adding strategic management and transactional skills to the Company.

Management believes the combination of the proceeds from the sale of its web hosting assets and Ampira, the equity unit purchase agreement, cash on-hand, its lower cost structure should be sufficient to sustain its operations in the near term. Management continues to reduce its monthly burn rate, primarily by reducing expenses. There is no assurance that the Company would not be faced with the prospect of requiring additional financing in the future.

Summary of cash flows for the years ended December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Cash used in operating activities	\$ (1,008,430)	\$ (1,131,576)
Cash provided by (used in) investing activities	597,043	(119,617)
Cash provided by financing activities	482,039	208,767

Cash used in operating activities primarily consists of the net income (loss) adjusted for non-cash items such as depreciation and amortization, compensation benefit and other non-cash items, and the effect of changes in working capital and other activities. Cash used in operating activities in 2006 of \$1,008,000 consisted primarily of net income of \$281,000, reduced by \$344,000 in non cash stock option compensation benefit and \$306,000 used in working capital and other activities. Cash used in operating activities in 2005 of \$1,132,000 consisted primarily of a net loss of \$461,000, \$350,000 in non cash stock option compensation benefit and \$290,000 used in working capital and other activities.

Cash provided by investing activities in 2006 of approximately \$597,000 was a result of proceeds from sale of asset of \$283,000 and the sale of a subsidiary of \$199,000. Cash used by investing activities in 2005 of approximately \$120,000 was primarily a result of the purchase of equipment of \$87,000 and the net purchases of short-term investments of \$40,000. Capital expenditures have generally been comprised of purchases of computer hardware, software and server equipment and are currently expected to remain modest in 2007 as the Company continues to manage discretionary spending.

Cash provided by financing activities in 2006 of \$482,000 was due to proceeds from the issuance of equity units subject to mandatory redemption of \$605,000, offset by the repayments made on the outstanding line of credit of \$206,000. Cash provided by financing activities in 2005 of \$209,000 was a result of net borrowings under a bank line of credit agreement of \$167,000 and \$42,000 as a result of proceeds from the exercise of stock options.

Employees

As of December 31, 2006 and 2005 the Company had 14 (of whom 5 were in sales and marketing and 6 were in product development) and 21 (of whom 10 were in sales and marketing and 8 were in product development) full-time employees, respectively. The remainder of the employees in both years was in operational support and administrative positions.

Board Member and Treasury Holdings

The share holdings of the Company's stock by board members and the Company at December 31, 2006 were as follows:

	<u>Number of Shares</u>	<u>US\$ Par Value</u>	<u>US\$ Market Value (FWB)</u>
Jeremy Metcalfe	20,569,853	\$ 205,699	\$ 1,974,706
Peter Hopper	2,522,898	25,229	242,198
James Pearson	1,513,738	15,137	145,319
Peter Macnee	160,478	1,605	15,406

FORTUNECITY.COM INC. AND SUBSIDIARIES

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DALESSIO, CASCIO & COMPANY, LLC

CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
FortuneCity.com Inc.:

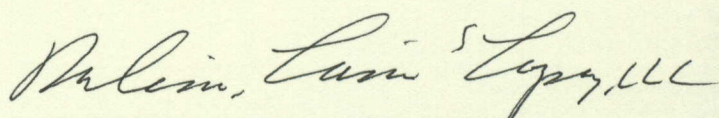
We have audited the accompanying consolidated balance sheets of FortuneCity.com Inc. (a Delaware corporation) and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, changes in stockholders' (deficit) equity and other comprehensive income (loss) and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of FortuneCity.com Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company has incurred recurring losses from operations, which resulted in negative working capital at December 31, 2006 and raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

New York, New York
March 23, 2007



DALESSIO, CASCIO & COMPANY, LLC
Certified Public Accountants

FORTUNECITY.COM INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2006 AND 2005
(in U.S. dollars)

<u>ASSETS</u>	<u>2006</u>	<u>2005</u>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 402,783	\$ 260,106
Short-term investments - restricted	-	200,576
Accounts receivable, net of allowance for doubtful accounts of \$75,000 and \$50,000, respectively	398,008	464,694
Prepaid expenses and other current assets	40,241	30,559
Assets of discontinued operation	-	107,871
Total current assets	<u>841,032</u>	<u>1,063,806</u>
 PROPERTY AND EQUIPMENT, net	 253,941	 186,558
 OTHER ASSETS	 <u>69,667</u>	 <u>87,083</u>
 Total assets	 <u><u>\$ 1,164,640</u></u>	 <u><u>\$ 1,337,447</u></u>
 <u>LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY</u>		
CURRENT LIABILITIES:		
Bank line of credit	\$ -	\$ 166,347
Accounts payable	213,718	585,839
Accrued expenses	156,242	183,506
Capital lease obligation	46,667	10,533
Other current liabilities	375,196	412,541
Liabilities of discontinued operation	-	111,192
Due to Hostopia	263,742	371,100
Total current liabilities	<u>1,055,565</u>	<u>1,841,058</u>
 Deferred rent	 47,606	 61,539
Capital lease obligation	81,119	18,516
Total liabilities other than shares	<u>1,184,290</u>	<u>1,921,113</u>
 Equity units subject to mandatory redemption; 4,541,216 and 0 units issued and outstanding, respectively; redemption value of \$681,182 and \$0, respectively	 <u>664,326</u>	 <u>-</u>
Total liabilities	<u>1,848,616</u>	<u>1,921,113</u>
 COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' (DEFICIT) EQUITY:		
Common stock; \$.01 par value; 80,000,000 shares authorized; and 42,119,410 and 41,401,865 shares issued and outstanding, respectively	421,194	414,019
Additional paid-in capital	120,049,636	120,416,279
Accumulated deficit	(118,177,297)	(118,458,291)
Other comprehensive loss	(2,977,509)	(2,955,673)
Total stockholders' (deficit) equity	<u>(683,976)</u>	<u>(583,666)</u>
Total liabilities and stockholders' (deficit) equity	<u><u>\$ 1,164,640</u></u>	<u><u>\$ 1,337,447</u></u>

FORTUNECITY.COM INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005 (in U.S. dollars)

	<u>2006</u>	<u>2005</u>
REVENUES	\$ 2,038,682	\$ 2,978,206
COST OF REVENUES	<u>834,384</u>	<u>1,418,031</u>
Gross profit	1,204,298	1,560,175
OPERATING EXPENSES:		
Sales and marketing	428,469	709,516
Product development	659,887	646,233
General and administrative	<u>513,732</u>	<u>790,069</u>
Total operating expenses	<u>1,602,088</u>	<u>2,145,818</u>
Operating loss	(397,790)	(585,643)
INTEREST INCOME	462	10,852
INTEREST EXPENSE	<u>(10,051)</u>	<u>(5,595)</u>
Loss from continuing operations before impact of sales of asset and subsidiary	(407,379)	(580,386)
GAIN ON SALE OF ASSET	464,785	-
GAIN ON SALE OF SUBSIDIARY	<u>218,086</u>	<u>-</u>
Impact of sales of asset and subsidiary	<u>682,871</u>	<u>-</u>
Net income (loss) from continuing operations	275,492	(580,386)
Earnings from discontinued operation	<u>5,502</u>	<u>119,707</u>
Net income (loss)	280,994	(460,679)
Accretion of equity units financing costs	<u>(58,994)</u>	<u>-</u>
Net income (loss) attributable to common stockholders	<u>\$ 222,000</u>	<u>\$ (460,679)</u>
Earnings (loss) per share - Basic:		
Continuing operations	<u>\$ 0.01</u>	<u>\$ (0.01)</u>
Discontinued operations	<u>\$ 0.00</u>	<u>\$ 0.00</u>
Attributable to common stockholders	<u>\$ 0.01</u>	<u>\$ (0.01)</u>
Earnings (loss) per share - Diluted:		
Continuing operations	<u>\$ 0.01</u>	<u>\$ (0.01)</u>
Discontinued operations	<u>\$ 0.00</u>	<u>\$ 0.00</u>
Attributable to common stockholders	<u>\$ 0.00</u>	<u>\$ (0.01)</u>
Shares used in per share calculation - basic	<u>41,900,973</u>	<u>41,119,332</u>
Shares used in per share calculation - diluted	<u>53,271,363</u>	<u>41,119,332</u>

The accompanying notes are an integral part of these consolidated statements.

FORTUNECITY.COM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' (DEFICIT) EQUITY AND OTHER COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

(in U.S. dollars)

	Common Stock		Additional	Accumulated	Accumulated Other Comprehensive	
	Shares	Amount	Paid-in Capital	Deficit	Loss *	Total
BALANCE, January1, 2005	40,492,889	\$ 404,929	\$ 120,734,754	\$(117,997,612)	\$ (2,678,763)	\$ 463,308
Foreign currency translation adjustment	-	-	-	-	(276,910)	(276,910)
Net loss	-	-	-	(460,679)	-	(460,679)
Total comprehensive loss						(737,589)
Exercise of stock options	908,976	9,090	33,330	-	-	42,420
Compensation benefit due to repricing of stock options	-	-	(351,805)	-	-	(351,805)
BALANCE, December 31, 2005	41,401,865	\$ 414,019	\$ 120,416,279	\$(118,458,291)	\$ (2,955,673)	\$ (583,666)
Foreign currency translation adjustment	-	-	-	-	(21,836)	(21,836)
Net income	-	-	-	280,994	-	280,994
Total comprehensive income						259,158
Exercise of stock options	717,545	7,175	35,879	-	-	43,054
Compensation benefit due to repricing of stock options	-	-	(366,200)	-	-	(366,200)
Adoption of SFAS 123R	-	-	22,672	-	-	22,672
Accretion of financing costs	-	-	(58,994)	-	-	(58,994)
BALANCE, December 31, 2006	42,119,410	\$ 421,194	\$ 120,049,636	\$(118,177,297)	\$ (2,977,509)	\$ (683,976)

* Compiled exclusively of foreign currency translation adjustment.

The accompanying notes are an integral part of these consolidated statements.

FORTUNECITY.COM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(in U.S. dollars)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 280,994	\$ (460,679)
Earnings from discontinued operation	\$ (5,502)	\$ (119,707)
Adjustments to reconcile net income (loss) to net cash used in operating activities-		
Depreciation and amortization	107,369	65,315
Non cash stock option (benefit) compensation charge	(343,528)	(351,805)
Loss on sale of property and equipment	9,051	-
Gain on sale of asset	(464,785)	-
Gain on sale of subsidiary	(218,086)	-
Unrealized foreign currency (loss) gains	-	(77,381)
Changes in operating assets and liabilities-		
Decrease (increase) in-		
Accounts receivable	66,686	(221,528)
Prepaid expenses and other current assets	(4,863)	(1,094)
Other assets	17,416	-
(Decrease) increase in-		
Accounts payable	(372,121)	26,172
Accrued expenses and other current liabilities	(74,469)	(65,170)
Due to Hostopia	74,905	96,868
Deferred rent	(13,933)	(13,936)
Net cash used in operating activities-continuing operations	(940,866)	(1,122,945)
Net cash used in operating activities-discontinued operation	(67,564)	(8,631)
Net cash used in operating activities	(1,008,430)	(1,131,576)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(79,239)	(86,765)
Payment of capital lease obligation	(18,328)	(4,136)
Purchases of short-term investments	-	(200,000)
Proceeds from maturity of short-term investments	200,576	159,360
Proceeds from sale of property and equipment	12,500	-
Net proceeds from sale of asset	282,522	-
Net proceeds from sale of subsidiary	199,012	-
Advance on sale of discontinued operation	-	11,924
Net cash provided by (used in) investing activities	597,043	(119,617)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of equity units subject to mandatory redemption	605,332	-
Borrowings under bank line of credit	39,846	185,063
Payment of bank line of credit	(206,193)	(18,716)
Proceeds from exercising of stock options	43,054	42,420
Net cash provided by financing activities	482,039	208,767
EFFECTS OF FOREIGN EXCHANGE	4,460	(7,138)
Increase (decrease) in cash and cash equivalents	75,112	(1,049,564)
Cash and cash equivalents, beginning of year	327,671	1,377,235
Cash and cash equivalents, end of year	402,783	327,671
Less cash and cash equivalents from discontinued operation, end of year	-	67,565
Cash and cash equivalents of continuing operations, end of year	\$ 402,783	\$ 260,106
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	\$ 10,051	\$ 5,501
SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS		
Capital lease obligations entered into for property and equipment	\$ 117,349	\$ 33,185

FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

1. ORGANIZATION AND BUSINESS

FortuneCity.com Inc. and its subsidiaries (“FortuneCity” or the “Company”) provide a variety of online web services and sells online advertising. The services are marketed through uniquely branded websites promoting each service as part of the FortuneCity global web property.

FortuneCity’s interactive media sales team leverages the Company’s global Internet audience to generate advertising revenue. Advertising impressions and revenue are generated primarily from FortuneCity’s three largest web properties; specifically the FortuneCity home page service, the V3 domain redirect service, and MyPhotoAlbum, the online photo and video sharing service. In addition, the Company represents and sells online advertising inventory and advertising solutions provided by third party web publishers.

MyPhotoAlbum provides photo enthusiasts the ability to store and share photos and videos online. The service is recognized for its extensive customization features that allow its registered users to create personalized online photo albums. The Company generates revenue from the sale of advertising, photo printing (including greeting cards, books and calendars), photo gift merchandise (including items such as coffee mugs, mouse pads and t-shirts), annual subscriptions to the MyPhotoAlbum premium service club and account reactivation fees. The photo printing services and the photo gift merchandise products are offered through private labeled fulfillment partnerships with professional photo processing labs, responsible to create, package and mail each order directly to the MyPhotoAlbum customer.

HotGames.com is an online games community featuring the best game downloads available in a safe, easy to use environment. Website visitors and returning customers can either download a free trial version of the full game, or play the online version in their internet browser. Users are regularly prompted to pay for the unlimited use of each game they have trialed or played online. The Company earns revenue through a revenue sharing agreement with the game publishers along with online advertising.

The Company also operates V3.com, the largest sub-domain redirect engine. Users select from a variety of short, memorable sub-domains that redirect internet traffic to another web address. Online advertisements are displayed each time a request is made for a V3 sub-domain.

The Company’s primary web services can be located at:

www.FortuneCity.com

www.MyPhotoAlbum.com

www.V3.com

www.HotGames.com

Liquidity

The Company has primarily funded its losses to date with the proceeds of its March 1999 initial public offering, which raised approximately \$87 million.



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

In July 2003, the Company secured a funding arrangement whereby one million Euros would be made available to the Company subject to it achieving certain cash flow milestones. The Company successfully achieved both milestones by January 2004, but it elected to draw down only 50% of the available funding, or 500,000 Euros.

In September 2004, FortuneCity sold its interest in North Carolina based data center Springboard Managed Hosting. The proceeds from the sale totaled \$692,000.

In 2006, the Company sold certain operating assets and liabilities for net cash proceeds of approximately \$482,000 (see Notes 12 and 13) in order to sustain its core business activities and allow it to focus on fewer operating activities.

In May 2006, the Company entered into an Equity Unit Purchase Agreement with a group of new investors raising net cash proceeds of approximately \$605,000 (see Note 10).

While management believes the combination of proceeds from the sale of certain assets, proceeds from the equity unit purchase agreement, cash on-hand and its lower cost structure should be sufficient to sustain its operations in the near term, there is no assurance that the Company would not be faced with the prospect of raising additional financing in the future.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements, which were prepared using accounting principles generally accepted in the United States of America (“GAAP”), include the accounts of FortuneCity and its wholly owned subsidiaries and are presented in U.S. dollars. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

Preparing the Company’s consolidated 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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates are related to the allowance for doubtful accounts, income taxes, contingencies and allocation of revenues by type for web services. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the result of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Cash and Cash Equivalents

The Company considers deposits that can be redeemed on demand and investments that have original maturities of less than three months, when purchased, to be cash equivalents. As of December 31, 2006, the Company's cash and cash equivalents were deposited in one financial institution.

Short-Term Investments

As part of its cash management program, the Company from time to time maintains a portfolio of marketable investment securities. The securities have an investment grade and a term to earliest maturity generally of less than one year and include certificates of deposit. These securities are carried at cost, which approximates market.

Fair Value of Financial Instruments

All of the Company's financial instruments are comprised of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and equity units subject to mandatory redemption. Their carrying amounts approximate fair value due to the short-term maturity of these instruments.

Unbilled Accounts Receivable

At December 31, 2006 and 2005, accounts receivable includes \$162,278 and \$405,717, respectively, of unbilled accounts receivable, which are a normal part of the Company's internet advertising business as some receivables are normally invoiced in the month following the completion of the earnings process.

Allowance for Doubtful Accounts

The Company determines its allowance for doubtful accounts based on the evaluation of the aging of its accounts receivable and a customer-by-customer analysis of high-risk customers. The Company's reserves contemplate its historical loss rate on receivables, specific customer situations and the economic environments in which the Company operates.

Property and Equipment

Property and equipment are recorded at cost less accumulated depreciation and amortization. Expenditures for major additions and improvements are capitalized, and minor replacements, maintenance, and repairs are charged to expense as incurred. When property and equipment are retired or otherwise disposed of, the cost and accumulated depreciation or amortization is removed from the accounts and any resulting gain or loss is included in the consolidated statements of operations for the respective period. Depreciation is provided over the estimated useful lives of the related assets using the straight-line method, ranging from three to five years, for financial statement purposes. The Company uses other depreciation methods (generally accelerated) for tax purposes where appropriate. Assets held under capital leases are recorded at the lower of the net present value of the minimum lease payments or the fair value of the leased asset at the inception of the lease. Amortization of leasehold improvements and equipment under capital lease is computed using the



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

straight-line method over the shorter of the estimated useful lives of the assets or the period of the related lease.

Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which applies the liability method of accounting for income taxes. Under this method, deferred tax liabilities and assets are determined based on the differences between the financial statement and tax bases of assets and liabilities using currently enacted tax rates. These differences are primarily due to bad debt, depreciation on fixed assets, amortization of intangible assets, deferred compensation and deferred rent expense. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

Revenue Recognition

Advertising

The Company's advertising revenues are derived principally from the sale of short-term online advertisements on the Company's network of web sites. The duration of the Company's advertising commitments generally ranged from one week to one month. Sponsorship advertising contracts typically have longer terms and involve more integration with the Company's network of sites, such as co-branded pages and placement of text links that provide users with direct links to the advertiser's web site.

Advertising revenues on both online advertisement contracts are recognized ratably over the period in which the advertisement is displayed, provided that no significant Company obligations remain at the end of a period and collection of the resulting receivable is probable. Company obligations typically include guarantees of minimum number of "impressions," or times that an advertisement appears in pages viewed by users of the Company's network of sites. To the extent minimum guaranteed impressions are not met, the Company defers recognition of the corresponding revenues related to the undelivered impressions until the remaining guaranteed impression levels are achieved.

The majority of the Company's advertising revenues are derived from direct advertising sales. Advertising revenues have been recorded net of agency fees.

Deferred Revenue

Deferred revenue is primarily comprised of billings or collections in excess of recognized revenue relating to advertising contracts and annual club membership paid in advance for MyPhotoAlbum. At December 31, 2006 and 2005, deferred revenue was \$85,809 and \$161,494, respectively, and was included in other current liabilities.



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Web Hosting Services

Revenues from web hosting services primarily consist of recurring subscription fees billed monthly, quarterly or annually. Revenues from web hosting services are recognized over the life of the service contract.

Domain registration revenues, consisting primarily of registration fees charged to customers for domain name registration services, are recorded net of fees paid to register the domains in the period in which the transaction occurs.

In January 2006, the Company sold its web hosting customer base. Accordingly, only one month of web hosting and domain registration revenues were recorded for the year ended December 31, 2006.

Marketing and Licensing Revenue

In January 2006, simultaneous with the sale of the web hosting customer base to Hostopia.com Inc. ("Hostopia") (Note 13), the Company entered into a marketing agreement with Hostopia for paid web hosting services. The Company leverages the traffic and goodwill associated with its web hosting brand name and website in return for a 57.5% share of new customer's revenue during the first year of service. Revenues from the marketing and licensing agreement are recognized when new customers subscription fees are earned by Hostopia based upon the service contract.

Photo Services

Revenues from photo services primarily consist of print and card sales, photo gift sales, club memberships and account reactivation fees. Revenues from prints, cards and gifts are recognized when the products are printed and shipped. Club membership revenue is recognized as the revenue is earned over the life of the membership (one year). Revenue from reactivation fees is recognized when the account is reactivated.

Due to Hostopia

As of December 31, 2006 and 2005, the caption on the accompanying consolidated balance sheets Due to Hostopia amounted to \$263,742 and \$371,100, respectively which is comprised of deferred revenue related to annual payments related to hosting services and amounts owed under the service agreement. In January 2006, the Company sold its paid hosting customer service contracts to Hostopia. In connection with the sale, Hostopia has agreed to offset the deferred revenue and amounts owed under the service agreement against the monthly purchase price payments (Note 13).

Advertising

Advertising costs are expensed as incurred. For the years ended December 31, 2006 and 2005, such costs were \$93,323 and \$141,228, respectively.



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Stock-Based Compensation

Prior to January 1, 2006, the Company applied APB Opinion No. 25, *Accounting for Stock Issued to Employees*, ("APB 25") and related interpretations in accounting for options granted under its stock option plan, except for its repriced stock options. Accordingly, no compensation cost was recognized in the financial statements with respect to stock options that were not repriced for the year ended December 31, 2005. Had compensation cost for the Company's plan been determined based on the fair value at the grant dates for awards under the plan, consistent with Statement of Financial Accounting Standards No. 123, *Accounting for Stock Based Compensation* ("SFAS 123"), as amended by Statement of Financial Accounting Standards No. 148, *Accounting for Stock Based Compensation-Transition and Disclosure* ("SFAS 148"), the pro forma net loss and loss per share for the year ended December 31, 2005 would have been as follows:

Net loss, as reported	\$	(460,679)
Net loss, fair value method		(462,586)
Stock based compensation benefit included in the determination of net loss as reported		351,805
Stock based compensation benefit that would have been included in the determination of net loss under the fair value method		349,898
Basic and diluted net loss per share, as reported	\$	(0.01)
Basic and diluted net loss per share, fair value method	\$	(0.01)

On June 1, 2003 the Company repriced all outstanding options to the then current market price of \$.06 and all shares became vested. These options originally had exercise prices ranging from \$.07 to \$.47. Statement of Financial Accounting Standards No. 123R, *Share-Based Payment* ("SFAS 123R"), requires that stock options that have been modified shall be accounted for as variable from the date of the modification to the date the option is exercised, forfeited or expires unexercised. For the years ended December 31, 2006 and 2005, the Company recorded compensation benefit in the amount of \$366,199 and \$351,805, respectively in connection with the repricing.

Effective January 1, 2006, the Company adopted SFAS 123R, using the modified prospective approach and accordingly prior periods have not been restated to reflect the impact of SFAS 123R. Under SFAS 123R, stock-based awards granted prior to its adoption are expensed over the remaining portion of their service period. These awards are expensed under an accelerated amortization approach using the same fair value measurements which were used in calculating pro forma stock-based compensation expense under SFAS 123. For stock-based awards granted on or after January 1, 2006, the Company records stock-based compensation expense on a straight-line basis the vesting period of 36 months. The Company did not grant stock options to employees for the year ended December 31, 2006. For the year ended December 31, 2006 the Company recorded compensation expense in the amount of \$22,672 related to these options.

Stock-based compensation expense recognized for the year ended December 1, 2006 is based on the value of the portion of stock-based payments awards that is ultimately expected to vest. SFAS 123R requires



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

forfeitures to be estimated at the time of grant in order to estimate the amount of stock-based awards that will ultimately vest. The estimate is based on the Company's historical rates of forfeiture. Stock-based compensation expense recognized in the statement of operations for the year ended December 31, 2006 includes (i) compensation expense for stock-based payment awards granted prior to, but not yet vested as of December 31, 2005, based on the grant-date fair value estimated in accordance with the pro forma provisions of SFAS 123 and (ii) compensation expense for stock-based payment awards granted subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. As stock-based compensation expense recognized in the statement of operations for the year ended December 31, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. In the Company's pro forma information required under SFAS 123 for the year ended December 31, 2005, the Company accounted for forfeitures as they occurred. The fair value of each option award is estimated on the date of grant using the Black-Scholes Model (See Note 9 for assumptions).

Product Development

Product development costs are expensed as incurred. Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based upon the Company's product development process, technological feasibility is established upon completion of a working model. Costs incurred by the Company between completion of the working model and the point at which the product is ready for general release have been insignificant.

Concentration of Credit Risk

Financial instruments which subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and trade accounts receivable. The Company maintains cash and cash equivalents with one financial institution. The Company performs periodic evaluations of the relative credit standing of this institution. From time to time, the Company's cash balances with any financial institution may exceed Federal Deposit Insurance Corporation limits.

The Company's customers are concentrated in the United States. The Company performs ongoing credit evaluations and generally does not require collateral.

The Company performs credit card authorizations of its customers prior to fulfillment of photo related orders. Credit risk is limited due to the collection of payments in advance or at the time of the transaction and the Company's large number of diversified customers.

For the years ended December 31, 2006 and 2005, one customer accounted for approximately 12% and 17% of total revenues, respectively.

At December 31, 2006, five customers accounted for 16%, 15%, 14%, 11% and 10% of Company's gross accounts receivable. At December 31, 2005, two customers accounted for approximately 10% and 10% of Company's gross accounts receivable.



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Risks Associated with Outsourcing Key Services

Certain key services that meet the Company's requirements are provided by a single supplier. The Company has contracted iLand Internet Solutions Corporation ("iLand"), a Level 3 Communications Inc. reseller, to provide a secure hosted environment for a majority of the Company's hardware infrastructure (Note 11). The inability of iLand to supply these services could result in disruption of the Company's business, which in turn could have a material adverse effect on the Company's business, financial condition, and results of operations.

401(k) Plan

The Company has a contributory 401(k) employee benefits plan covering substantially all of its employees. The Company made no contribution to the plan for the years ended December 31, 2006 and 2005.

Foreign Currency

The assets and liabilities of the Company's foreign subsidiaries are translated into U.S. dollars at exchange rates as of the balance sheet date. Revenues and expenses are translated at the average of the rates prevailing during the year. Adjustments from translating foreign currency financial statements are reported in other comprehensive income (loss) as a separate component of stockholders' (deficit) equity. The currency of the country of domicile is the functional currency of each of the Company's subsidiaries. As of December 31, 2006, the Company has no active foreign subsidiaries (Note 7).

New Accounting Pronouncements

In July 2006, the FASB issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, ("FIN 48") as an interpretation of FASB Statement No. 109, *Accounting for Income Taxes* ("SFAS 109"). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109 and prescribes a recognition threshold of more-likely-than-not to be sustained upon examination. Measurement of the tax uncertainty occurs if the recognition threshold has been met. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company does not believe that the adoption of FIN 48 will have a material effect on the financial position, cash flows or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157") which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently assessing



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

whether adoption of SFAS 157 will have an impact on the financial position, cash flows or results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS 159") which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. This statement is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing whether adoption of SFAS 159 will have an impact on the financial position, cash flows or results of operations.

Reclassifications

Certain reclassifications have been made to the prior years' financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

3. BASIC AND DILUTED NET INCOME (LOSS) PER SHARE

Basic net income (loss) per common share is computed using the weighted-average common shares outstanding for the period. Diluted net income (loss) per common share is computed using the weighted-average common shares outstanding plus any potentially dilutive securities, except when their effect is anti-dilutive. The dilutive effect of outstanding stock options and warrants is reflected in diluted earnings per share by application of the treasury stock method. For the year ended December 31, 2005, diluted net loss per common share is computed using the weighted-average common shares outstanding for the period and excludes all potentially dilutive securities because the Company is in a net loss position and their inclusion would have been anti-dilutive. Dilutive securities primarily include stock options, warrants and equity units subject to mandatory redemption.

FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

The computation of basic earnings per share and diluted earnings (loss) per share for “Income (loss) from continuing operations” for the years ended December 31, 2006 and 2005 is as follows:

	2006	2005
Income (loss) from continuing operations	<u>\$ 275,492</u>	<u>\$ (580,386)</u>
Weighted-average number of common shares outstanding—Basic	41,900,973	41,119,332
Weighted average effect of dilutive securities		
Equity units subject to mandatory redemption	2,686,022	-
Employee stock options	6,915,999	-
Warrants	<u>1,768,369</u>	<u>-</u>
Weighted-average number of common shares outstanding—Diluted	<u>53,271,363</u>	<u>41,119,332</u>
Net earnings (loss) per share from continuing operations:		
Basic	\$ 0.01	\$ (0.01)
Diluted	<u>\$ 0.01</u>	<u>\$ (0.01)</u>

The following securities have been excluded from the diluted net earnings (loss) per share calculation because the respective exercise prices are greater than the average market value of the underlying stock or their inclusion would have been anti-dilutive for the years ended December 31, 2006 and 2005:

	2006	2005
Employee stock options	50,000	7,415,402
Warrants	6,506,241	2,000,000



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

4. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2006 and 2005 consist of the following:

	<u>2006</u>	<u>2005</u>
Computer equipment	\$ 364,366	\$ 173,245
Office equipment	34,457	84,229
Leasehold improvements	12,038	12,038
Computer software	19,640	14,457
	<u>430,501</u>	<u>283,969</u>
Less: Accumulated depreciation and amortization	<u>(176,560)</u>	<u>(97,411)</u>
	<u><u>\$ 253,941</u></u>	<u><u>\$ 186,558</u></u>

Depreciation and amortization expense was \$107,369 and \$65,315 for the years ended December 31, 2006 and 2005, respectively.

In December 2006, the Company sold furniture for \$12,500 to a stockholder and former board member. The loss from the sale was \$9,051 and is included in general and administrative expenses in the consolidated statement of operations for the year ended December 31, 2006.

5. BANK LINE OF CREDIT

In July 2005, the Company entered into a revolving line of credit agreement with a bank that allowed the Company to borrow up to \$200,000. The line of credit was fully secured by a certificate of deposit classified as short-term investments-restricted on the accompanying balance sheet as of December 31, 2005. Borrowings under the line of credit bear interest at 8%. The outstanding balance was \$166,347 at December 31, 2005. In April 2006, the company redeemed the certificate of deposit, repaid the entire balance outstanding on the line of credit and closed the revolving line of credit.

6. CAPITAL LEASE OBLIGATION

The Company leases certain computer equipment under agreements that are classified as capital leases. The cost of equipment under capital leases is included in the Consolidated Balance Sheets as property and equipment and was \$150,534 and \$33,185 at December 31, 2006, and December 31, 2005, respectively. Accumulated amortization of the leased equipment at December 31, 2006, and December 31, 2005, was approximately \$24,707 and \$4,609, respectively. Amortization of assets under capital leases is included in depreciation expense.



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2006, are as follows:

	Year Ending December 31,	Amount
	2007	\$ 67,250
	2008	61,420
	2009	39,943
Total minimum lease payments		<u>168,613</u>
Less: Amount representing estimated taxes and insurance costs included in total amounts above		<u>(17,893)</u>
Net minimum lease payments		150,720
Less: Amount representing interest		<u>(22,934)</u>
Present value of net minimum lease payments		127,786
Less: Current maturities of capital lease obligations		<u>(46,667)</u>
Long-term capital lease obligations		<u><u>\$ 81,119</u></u>

7. OTHER CURRENT LIABILITIES

At December 31, 2006 and 2005, Other Current Liabilities include approximately \$220,000 and \$198,000, respectively of liabilities relating to inactive subsidiaries. These liabilities will be paid or credited to income when these subsidiaries are dissolved.



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

8. INCOME TAXES

The primary components of temporary differences which give rise to deferred taxes are as follows:

	December 31,	
	2006	2005
Deferred tax asset:		
Net operating loss carryforward	\$ 41,270,000	\$ 42,774,000
Allowance for doubtful accounts	30,000	20,000
Depreciation and amortization	900,000	1,004,000
Deferred rent	20,000	25,000
Deferred compensation	101,000	247,000
Accruals	38,000	18,000
Deferred tax assets before valuation allowance	42,359,000	44,088,000
Less: valuation allowance	(42,359,000)	(44,088,000)
Net deferred tax assets	\$ -	\$ -

As a result of the Company's history of operating losses, management believes a valuation allowance for the entire net deferred tax asset, after considering deferred tax liabilities, is required. As of December 31, 2006 and 2005, the Company had estimated net operating loss carryforwards of approximately \$104,298,00 and \$106,934,000, respectively.

The net operating loss carryforwards originated in the following jurisdictions:

	December 31,	
	2006	2005
United States	\$ 88,294,418	\$ 83,490,396
Germany	-	7,440,039
The Netherlands	12,189,216	12,189,216
Other	3,814,094	3,814,094
	<u>\$ 104,297,728</u>	<u>\$ 106,933,745</u>

As of December 31, 2006 U.S. loss carryforwards expire through 2026. The Netherlands loss carryforwards have no expiration.

The Company utilized approximately \$4,557,000 of its net operating loss carryforwards during the year ended December 31, 2006 to offset foreign income taxes related to the sale of the Company's German subsidiary.



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

9. STOCKHOLDERS' (DEFICIT) EQUITY

Exercising of Employee Stock Options

For the years ended December 31, 2006 and 2005, the Company issued 717,545 and 908,976 shares of its common stock for cash proceeds of \$43,054 and \$42,420, respectively.

Preferred stock

Effective March 3, 1999 the Company's Board of Directors authorized 10,000,000 shares of preferred stock to be issued. As of December 31, 2006 these shares have not been issued and the Company currently has no plans to issue the shares.

Stock Plan

In May 1998, the Company adopted the 1998 Stock Option Plan, as amended (the "Plan"), which provides for the issuance of up to 23,600,000 shares for both non-statutory and incentive stock options to employees, officers, consultants and non-employee directors. Most options shall be exercisable for a period of up to ten years from the date of grant at no less than 100% of the fair market value of the Company's common stock on the date of grant. The term of such options shall be five years from the date of grant for stockholders who own more than ten percent of the voting power of all classes of stock of the Company at the date of grant. At December 31, 2006 and 2005, 10,465,999 and 10,465,999 options were available for issuance, respectively.

The following table presents the weighted-average assumptions used to estimate the fair values of the stock options granted in the periods presented:

	Year ended December 31,	
	2006	2005
Risk-free interest rate	4.90%	4.18%
Expected volatility	116.00%	176.00%
Expected life (in years)	5	5
Dividend yield	-	-



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

The following summarizes the activity under the Plan:

	Options		
	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Balance, December 31, 2004	13,074,681	\$ 0.06	
Granted	350,000	0.13 - 0.15	
Exercised	(908,976)	0.06	
Canceled	(624,024)	0.06	
Balance, December 31, 2005	11,891,681	\$ 0.06	
Granted	-	-	
Exercised	(717,545)	0.06	
Canceled	(219,391)	0.06	
Balance, December 31, 2006	10,954,745	\$ 0.06	\$ 385,371
Exercisable at December 31, 2006	10,804,245	\$ 0.06	\$ 385,371

The following table summarizes information about stock options outstanding at December 31, 2006:

Range of Exercise Prices	Number Outstanding at December 31, 2006	Remaining Contractual Life	Weighted Average Exercise Price	Weighted Average Grant- date Fair Value
\$ 0.06 - 0.23	10,954,745	4.71 years	\$ 0.06	\$ 0.06

The weighted average exercise price and the weighted average grant-date fair value for the exercisable stock options are \$0.06, respectively, for the year ended December 31, 2006.

The total intrinsic value of options exercised during the years ended December 31, 2006 and 2005 amounted to \$100,232 and \$75,788, respectively.



FORTUNECITY.COM INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

A summary of the status of the Company's nonvested shares at December 31, 2006 and 2005, and changes during the years ended December 31, 2006 and 2005 is presented below:

	Options	
	Shares	Weighted Average Grant- date Fair Value
Balance, December 31, 2004	50,000	\$ 0.23
Granted	350,000	0.14
Vested	(16,500)	0.23
Forfeited	-	-
Balance, December 31, 2005	383,500	\$ 0.15
Granted	-	-
Vested	(83,000)	0.15
Forfeited	(150,000)	0.15
Balance, December 31, 2006	150,500	\$ 0.14

As of December 31, 2006, there was approximately \$20,000 of total unrecognized compensation cost related to stock-based compensation arrangements. The cost is expected to be recognized on a straight line basis over the remaining vesting period of the stock option award through the second quarter of 2008. The total fair value of shares vested during the years ended December 31, 2006 and 2005 was \$22,672 and \$1,907, respectively.

Warrants

In July 2003, the Company entered into an equity line of credit agreement with a Partnership controlled by the Company's major stockholder that expired on December 31, 2005. In return for this funding commitment the Company agreed to issue the Partnership a four-year warrant to purchase up to 10,000,000 shares of common stock at a price of \$.12 cents per share. The warrant issued in connection with the equity line of credit agreement includes certain antidilution provisions in the event shares are issued below the warrant exercise price of \$.12 cents. For the year ended December 31, 2006, no warrants were exercised and the warrants were cancelled in connection with the equity unit purchase agreement (Note 10).



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10. EQUITY UNITS SUBJECT TO MANDATORY REDEMPTION

Equity units subject to mandatory redemption consists of the following:

Common Shares	\$ 358,041
Value of warrant	323,141
Unamortized financing costs	(16,856)
Equity units subject to mandatory redemption	<u>\$ 664,326</u>

On May 22, 2006 the Company entered into an Equity Unit Purchase Agreement (the “Agreement”) with new investors. Per the terms of the Agreement, the Company issued and sold equity units, each consisting of one share of the Company’s common stock and a warrant to purchase 2.4225 shares of the Company’s common stock, for an exercise price of \$0.15 per share. The Company issued 4,541,216 equity units at a price of \$0.15 for aggregate proceeds of \$681,182. The Company issued 4,036,636 equity units for aggregate proceeds of \$605,495 on May 22, 2006 and 504,580 equity units for aggregate proceeds of \$75,687 on August 3, 2006. In connection with this transaction, the Company incurred fees of \$75,850, which have been deferred and are being accreted to additional paid-in capital over nine months. For the year ended December 31, 2006, \$58,994 was accreted through a charge to additional paid-in capital in the accompanying consolidated statement of changes in stockholders’ (deficit) equity and other comprehensive income (loss). The Company issued 11,000,000 warrants in connection with the sale of the equity units. The Agreement allocated \$0.135 to each share of common stock and \$0.015 to each warrant.

The associated Warrants are exercisable for 11,000,000 shares of common stock at an exercise price of \$0.15 per share. The Company engaged an independent financial consultant to prepare the valuation of the warrant based upon the Black-Scholes valuation model. Based upon the independent valuation the warrant had a value of \$0.15 as of May 22, 2006. The Company has determined the value of the stock and the warrant based on the pro-rata fair values of the market value of the stock as of May 22, 2006 (\$0.1662) and an independent valuation of the warrant (as of May 22, 2006). The Warrants will expire seven years after issuance. The following assumptions were used to determine the fair value of the Warrants using the Black-Scholes valuation model: a term of seven years, risk-free rate of 4.96%, volatility of 116%, and dividend yield of zero.

Put and Call Options

The Agreement includes Put and Call arrangements, which will grant to the Company the option to call, or buy back the shares of the Company’s common stock from the investors and grant to the investors the option to put, or sell the shares of the Company’s common stock to the Company. The arrangement exists in order to give the respective parties the ability to unwind the investment in the event that certain performance related requirements are not satisfied.

The performance related requirements are identified as either the Company closing on a “Qualified Acquisition” or the investors meeting an “Activity” criteria. A “Qualified Acquisition” shall mean an acquisition of a business (by way of a purchase of assets, an Equity Transaction or otherwise), which has generated revenues of at least \$2,000,000 for the twelve months prior to acquisition or \$500,000 in the fiscal quarter prior to acquisition or has annual earnings before interest, tax, depreciation and amortization of at



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least \$1,000,000 for the twelve months prior to acquisition or \$250,000 in the fiscal quarter prior to acquisition. In addition, the Board of Directors of the Company may elect to deem any acquisition not satisfying these criteria as a Qualified Acquisition. The “Activity” criteria shall mean the investors active engagement during a period of ninety consecutive days in one or more of the actions required to complete a Qualified Acquisition. The activities may include, but not be limited to, identifying, analyzing, negotiating or structuring financing for any potential acquisition.

The Put and Call Option I (“Put and Call I”) commences nine months (February 22, 2007) from closing (May 22, 2006) and lasts for 60 days. The Put window that opens at this time may be triggered by the Investors at their option. The Call window that opens at this time may only be triggered by the Company if a Qualified Acquisition has not closed and if the Investors have not satisfied the meaning of Activity, as defined in the Agreement. If the Put or Call is triggered for the nine months window, then the strike price shall be \$.15 per share for the shares included in the Equity Units purchased by the Investors, but shall not apply to any Warrant Shares purchased as result of exercising the Warrants. The price shall be paid in cash by the Company within thirty days of either party exercising their option. All unexercised Warrants shall be voided at that time and all Board representation by any Investor shall immediately lapse. If the Investors fail to meet the activity requirement for a period of ninety consecutive days within the nine month window, the Put strike price shall be \$.075 per share for the Shares purchased by the Investors, but will not apply to any warrant shares purchased as result of exercising the Warrants. In the event that a Qualified Acquisition is completed during the nine month window, the Put and Call Option I shall immediately lapse.

The Put and Call Option II (“Put and Call II”) commences 12 months (May 22, 2007) from closing (May 22, 2006) and lasts for 180 days. The put and call window that opens twelve months from Closing may be triggered by either the Investors or the Company if no Qualified Acquisition has been closed and the Investor have not satisfied the meaning of Activity in the six months prior to the twelve month window opening. The Investors shall direct their nominees on the Board of Directors to abstain from voting on the exercise of any call option under Put and Call Option II. If the put is exercised by the Investors at the twelve month window, the purchase price shall be \$.075 per share for the Shares included in the Equity Units purchased by the Investors, but shall not apply to any Warrant Shares purchased as result of exercising the Warrants. All unexercised Warrants shall be voided at that time and all Board representation by any Investor shall immediately lapse. If the call is exercised by the Company at the twelve month window, the purchase price shall be \$.15 per share for the Shares included in the Equity Units purchased by the Investors, but shall not apply to any Warrants Shares purchased as a result of exercising the Warrants.

Liquidation Value

The 4,541,216 shares of common stock that the Company issued in conjunction with the Agreement are subject to redemption as outlined by the Put and Call agreements above. During the time period associated with Put and Call I, each share has a liquidation value of \$0.15 per share. During the time period associated with Put and Call II, each share has a liquidation value of \$0.075 per share. The liquidation value is payable within thirty days of either party exercising their option.



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11. COMMITMENTS AND CONTINGENCIES

Leases

In January 2007 the Company entered into an agreement with its landlord in New York to terminate its lease effective February 1, 2007 and entered into a new lease through February 2010. The Company's minimum lease obligations under the lease is as follows:

<u>Year ending December 31,</u>	<u>Amount</u>
2007	\$ 79,200
2008	95,040
2009	95,040
2010	15,840
Total minimum lease payments	<u><u>\$ 285,120</u></u>

Rent expense for the years ended December 31, 2006 and 2005 was \$145,067 and \$231,301, respectively. Rent expense for the year ended December 31, 2006 includes rental income of \$50,000.

The Company's old and new office leases include rent abatement periods. The deferred rent liability on the accompanying consolidated balance sheets represents the difference between the total rent payments made and the average monthly obligations over the life of the leases. The old lease required a security deposit in the amount of \$87,083 which is included in other assets on the consolidated balance sheet at December 31, 2005. The old lease had a provision to reduce the deposit to \$69,667 on March 1, 2006, which is included in other assets on the consolidated balance sheet at December 31, 2006. The new lease requires a deposit of \$23,760.

Master Services Agreement

In March 2004, the Company entered into an agreement with SunGard Availability Services ("SunGard") for co-location data center services including internet connectivity, power, managed storage solution and server rack space. The agreement is for 27 months beginning in May 2004 and requires the Company to pay monthly recurring charges for a secure hosted environment for a majority of the Company's hardware infrastructure including a managed data storage and backup solution. In 2005, the Company renegotiated the agreement to extend the term through November 2007. In 2006, the Company renegotiated the agreement to terminate it effective October 2006 and negotiated a new agreement with iLand Internet Solutions Corporation. This agreement is for 24 months beginning in October 2006 and requires the Company to pay monthly recurring charges for a secure hosted environment for a majority of the Company's hardware infrastructure. The costs associated with these agreements amounted to \$258,308 and \$497,016 for the years ended December 31, 2006 and 2005, respectively, and is included in the cost of revenues in the Company's consolidated statements of operations.



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Strategic Services Agreement

In November 2004, the Company entered into an agreement with Hostopia.com Inc. ("Hostopia") to provide a private labeled web hosting solution. Under the agreement, Hostopia provides the web hosting, domain and email services, along with customer support for the Company's FortuneCity.com paid hosting subscribers. The agreement was for 36 months beginning in January 2005 and requires the Company to pay monthly recurring charges for the services provided to FortuneCity end users. The costs associated with this agreement amount to \$38,629 and \$410,303, respectively, for the years ended December 31, 2006 and 2005 and is included in the cost of revenues in the Company's consolidated statements of operations. In January 2006, the Company agreed to sell its paid hosting customers to Hostopia (Note 13). As part of the sale, this agreement with Hostopia was terminated, and all associated termination fees were waived.

Marketing and Licensing Agreement

On January 31, 2006, the Company entered into a marketing and licensing agreement with Hostopia for the period February 1, 2006 through January 31, 2008 with an option to extend for an additional year. The Company has agreed to continue to market domain, email and hosting services under the FortuneCity brand name and refer customers to Hostopia in exchange for referral fees. The Company receives 57.5% of new customer's revenue during the first year of service. The Company will continue to own and operate the FortuneCity.com website and seamlessly refer prospective paid web hosting customers to web pages maintained by Hostopia. This will have an impact on the amount of new business obtained for Hostopia which accordingly will affect the amount of referral fees generated for the Company. The referral fee will be paid on new customers that have entered into contracts subsequent to January 31, 2006, as defined in the marketing and licensing agreement. For the year ended December 31, 2006, the Company recorded revenue of \$96,707 under the marketing and licensing agreement.

Contingencies

From time to time, the Company has been party to various litigation and administrative proceedings relating to claims arising from its operations in the normal course of business. Management believes that the resolution of these matters will not have a material adverse effect on the Company's business, results of operations, financial condition or cash flows.

12. DISCONTINUED OPERATION

In December 2005, the Company decided to sell its Hamburg, Germany based online media sales subsidiary, Ampira GmbH ("Ampira") to KON AG Klinkhammer Online ("KON") in order to focus its business activities in the North American market.

On March 24, 2006, the Company sold the stock of Ampira for approximately \$244,000. In December 2005, the Company received \$12,000 upon signing of the letter of intent. At the closing the Company received approximately \$177,000 for aggregate proceeds of \$189,000. The balance of the purchase price (\$55,000) was paid in equal installments over a 10 month period commencing on April 24, 2006. At December 31, 2006, one monthly installment remained outstanding in the amount of \$4,819 and was classified in prepaid



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expenses and other current assets on the consolidated balance sheet. This installment was received in February 2007. The assets sold consisted primarily of accounts receivable and other assets. The buyer also assumed certain accounts payable and accrued liabilities.

In March 2006, a gain on disposal of \$218,086, as detailed below was recorded in the consolidated statement of operations:

Cash consideration received	\$ 244,577
Write-down of assets	(2,128)
Commissions	(12,183)
Legal fees	<u>(12,180)</u>
Gain on sale of subsidiary	<u>\$ 218,086</u>

Ampira's sales, reported in discontinued operation, for years ended December 31, 2006 and 2005, were \$152,256 and \$816,276, respectively. Ampira's net income, reported in discontinued operation, for the years ended December 31, 2006 and 2005, were \$5,502 and \$119,707, respectively.

The following is a summary of the net assets sold as initially determined at December 31, 2005 and as finally reported on the closing date of March 24, 2006:

	March 24, 2006	December 31, 2005
Assets of discontinued operation:		
Cash	\$ 57,249	\$ 67,565
Accounts receivable	48,628	23,885
Other assets	26,177	16,421
Total assets	<u>\$ 132,054</u>	<u>\$ 107,871</u>
Liabilities of discontinued operation:		
Accounts payable	\$ 91,335	\$ 66,554
Accrued expenses	38,615	22,075
Other current liabilities	-	22,563
Total liabilities	<u>\$ 129,950</u>	<u>\$ 111,192</u>



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13. GAIN ON SALE OF ASSET

On January 31, 2006, the Company sold its paid web hosting assets to Hostopia.com Inc. The paid web hosting assets consists of existing service contracts with customers. The contingent purchase price is \$1,132,000 less total liabilities of \$423,000 resulting in potential cash proceeds of \$700,000. The total liabilities include amounts owed from the prior wholesale service agreement and deferred revenue as of January 31, 2006. The Company received a net payment of \$151,400 at the closing.

The remainder of the contingent purchase price is being paid monthly. The computation is based on revenues that are generated from customers of the Company that had entered into a service agreement with the Company prior to the closing date for web hosting services, and continue to pay for such services after closing ("continuing revenues"), times a purchase price payment percentage as defined in the agreement. Hostopia has agreed to assume the deferred revenue for the paid web hosting assets as of January 31, 2006. Hostopia will offset the deferred revenue liability and an outstanding accounts payable balance as of January 31, 2006 against the purchase price payments. The monthly payment of the total liabilities will be computed by taking the continuing revenues multiplied by 50% minus the purchase price payment percentage. The purchase agreement will continue until the purchase price of \$1,132,000 is paid or when there are no longer continuing revenues. In the event Hostopia does not generate sufficient continuing revenues to pay the remaining balance of the outstanding liabilities, the Company is obligated to pay the outstanding debt.

For the year ended December 31, 2006, a gain on sale of asset of \$464,785, as detailed below was recorded in the consolidated statement of operations:

Consideration received	
Cash consideration received	\$ 286,471
Offset of outstanding liabilities	171,942
Year end receivable on payments received	10,321
Total consideration received	<u>468,734</u>
Legal fees	<u>(3,949)</u>
Gain on sale of asset	<u>\$ 464,785</u>

14. SUBSEQUENT EVENTS

In January 2007, the Company entered into an agreement with its landlord that permitted the Company to terminate the Lease before the expiration date (May 29, 2010). As part of this agreement, the Company entered into an operating lease agreement for new office space. Payments under the lease will commence in February 2007 and will continue through the initial lease term of thirty seven months.



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