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CITY NETWORK INC  
Form 10QSB  
August 21, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-QSB

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

FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2006

COMMISSION FILE NUMBER: 001-31954

CITY NETWORK, INC.  
(Name of Small Business Issuer as Specified in its Charter)

Nevada  
(State or Other Jurisdiction of  
Incorporation or Organization)

88-0467944  
(I.R.S. Employer  
Identification No.)

2F-1, No. 16, Jian Ba Road, Chung Ho City  
Taipei County 235, Taiwan, ROC  
(Address of Principal Executive Offices)

011-886-2-8226-5566  
(Telephone Number)

Check whether the Issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No .

As of August 21, 2006, there were 34,967,183 shares of common stock, par value \$0.001 per share, outstanding.

Transitional Small Business Disclosure Format (check one): Yes  No .

Table Of Contents

|   |    |
|---|----|
| PART I - FINANCIAL INFORMATION.....   | 3  |
| Item 1. Financial Statements.....   | 3  |
| Item 2. Management's Discussion and Analysis of Financial Condition<br>and Results of Operations..... | 27 |
| Item 3. Controls and Procedures.....  | 31 |
| PART II - OTHER INFORMATION.....  | 32 |
| Item 1. Legal Proceedings.....  | 32 |

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds..... 32

Item 3. Defaults Upon Senior Securities..... 32

Item 4. Submission of Matters to a Vote of Security Holders..... 32

Item 5. Other Information..... 32

Item 6. Exhibits..... 33

SIGNATURES..... 34

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CITY NETWORK INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

|  | June 30, 2006 | December 31, 2005 |
|--|---------------|-------------------|
|  | -----         | -----             |
|  | (Unaudited)   |                   |
| ASSETS                                     |               |                   |
| CURRENT ASSETS:                            |               |                   |
| Cash and cash equivalents                  | \$ 30,889     | \$ 856,587        |
| Accounts receivable, net                   | 2,119,117     | 4,371,110         |
| Inventories                                | 857,950       | 252,608           |
| Construction in progress                   | 864,540       | 418,105           |
| Other receivables                          | 533,136       | 241,304           |
| Prepayment                                 | 5,227,351     | 3,500,021         |
| Short-term investments-net                 | 920,100       | --                |
|  | -----         | -----             |
| TOTAL CURRENT ASSETS                       | 10,553,083    | 9,639,735         |
|  | -----         | -----             |
| PROPERTY, PLANT AND EQUIPMENT              | 4,172,917     | 2,243,214         |
|  | -----         | -----             |
| OTHER ASSETS:                              |               |                   |
| Deposits                                   | 423,296       | 503,579           |
| Cash held for compensating balances        | 1,289,143     | 1,380,992         |
| Intangible assets                          | 896,207       | 925,074           |
| Deferred assets                            | 377,124       | 148,208           |
| Equity in net assets of affiliated company | 838,803       | 790,842           |
|  | -----         | -----             |
| TOTAL OTHER ASSETS                         | 3,824,573     | 3,748,695         |
|  | -----         | -----             |
| TOTAL ASSETS                               | \$18,550,573  | \$15,631,644      |
|  | =====         | =====             |

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|  | June 30, 2006 | December 31, 2005 |
|--|---------------|-------------------|
|  | -----         | -----             |
|  | (Unaudited)   |                   |
| LIABILITIES AND STOCKHOLDERS' EQUITY   |               |                   |
| CURRENT LIABILITIES:   |               |                   |
| Accounts payable and accrued expenses  | \$ 1,583,860  | \$ 1,471,867      |
| Convertible note payable, net  | --            | 250,000           |
| Due to related party   | 993,095       | 1,131,494         |
| Deferred revenue   | 4,100,930     | 3,198,414         |
| Current portion, long-term debt  | 4,737,422     | 4,220,230         |
|  | -----         | -----             |
| TOTAL CURRENT LIABILITIES  | 11,415,307    | 10,272,005        |
| NON-CURRENT LIABILITIES:   |               |                   |
| Convertible note payable, net  | 530,000       | --                |
| Long-term debt, net of current portion   | 2,049,155     | 572,668           |
|  | -----         | -----             |
| TOTAL NON-CURRENT LIABILITIES  | 2,579,155     | 572,668           |
| TOTAL LIABILITIES  | 13,994,462    | 10,844,673        |
|  | -----         | -----             |
| STOCKHOLDERS' EQUITY:  |               |                   |
| Common stock, \$.001 par value, 100,000,000 shares authorized, 32,967,183 shares issued outstanding at June 30, 2006 and December 31, 2005 | 32,967        | 32,967            |
| Additional paid in capital   | 6,282,979     | 6,157,479         |
| Other comprehensive income   | 450,374       | 366,384           |
| Accumulated deficit  | (2,210,209)   | (1,769,859)       |
|  | -----         | -----             |
| TOTAL CAPITAL AND RETAINED DEFICIT   | 4,556,111     | 4,786,971         |
| Less: cost of treasury stock   | --            | --                |
|  | -----         | -----             |
| Total Stockholders' Equity   | 4,556,111     | 4,786,971         |
|  | -----         | -----             |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY   | \$ 18,550,573 | \$ 15,631,644     |
|  | =====         | =====             |

4

CITY NETWORK, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

|               | Three Months Ended June 30, |              | Six    |
|---------------|-----------------------------|--------------|--------|
|               | -----                       | -----        | -----  |
|               | 2006                        | 2005         | 2005   |
|               | -----                       | -----        | -----  |
| Sales, net    | \$ 597,758                  | \$ 3,599,366 | \$ 3,1 |
| Cost of sales | 452,463                     | 3,377,970    | 2,8    |

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|  |              |              |       |
|--|--------------|--------------|-------|
|  | -----        | -----        | ----- |
| Gross Profit                           | 145,295      | 221,396      | 3     |
| General and administrative expenses    | 534,576      | 376,241      | 8     |
|  | -----        | -----        | ----- |
| Income (loss) from operations          | (389,281)    | (154,845)    | (5)   |
|  | -----        | -----        | ----- |
| Other (Income) Expense                 |              |              |       |
| Interest income                        | (11,680)     | (1,688)      | (     |
| Rental income                          | (15,590)     | (47,910)     | (     |
| Commission income                      | (160)        | (31,870)     | (     |
| (Gain) Loss on currency exchange       | (209)        | 4,977        |       |
| Other income                           | (69,680)     | (56,239)     | (1    |
| Reserve for bad debt                   | 22,548       | 11,154       |       |
| Equity in earnings of investee         | (77,232)     | (531)        | (     |
| Loss on physical inventory             | 42,874       | --           |       |
| Miscellaneous                          | (11,194)     | 46,186       |       |
| Loss on sale of fixed assets           | (724)        | (2,280)      |       |
| Interest expense                       | 66,588       | 42,898       | 1     |
|  | -----        | -----        | ----- |
| Total other (income) expense           | (54,459)     | (35,303)     | (1    |
|  | -----        | -----        | ----- |
| Loss before income taxes               | (334,822)    | (119,542)    | (4    |
| Provision for income taxes             | --           | 178          |       |
|  | -----        | -----        | ----- |
| Net loss                               | \$ (334,822) | \$ (119,720) | \$ (4 |
|  | =====        | =====        | ===== |
| Net loss per share (basic and diluted) |              |              |       |
| Basic                                  | \$ (0.012)   | \$ (0.004)   | \$    |
|  | =====        | =====        | ===== |
| Diluted                                | \$ (0.012)   | \$ (0.004)   | \$    |
|  | =====        | =====        | ===== |
| Weighted average number of shares      |              |              |       |
| Basic                                  | 28,521,728   | 27,500,000   | 28,5  |
| Diluted                                | 28,521,728   | 27,500,000   | 28,5  |

5

CITY NETWORK, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

|   | Six Months Ended June |        |
|---|-----------------------|--------|
|   | 2006                  | 2      |
|   | -----                 | -----  |
| CASH FLOWS FROM OPERATING ACTIVITIES  |                       |        |
| Net Loss  | \$ (440,350)          | \$ (1, |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                       |        |
| Depreciation and amortization   | 96,521                |        |
| Equity in earnings of investee  | (47,961)              |        |

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|  |             |       |
|--|-------------|-------|
| Bad debt   | 37,541      |       |
| (Gain) Losses on disposal of fixed assets                    | (724)       |       |
| Loss on physical inventory                                   | 42,894      |       |
| Loss on foreign currency exchange                            | --          |       |
| Decrease in receivables                                      | 2,274,300   |       |
| Increase in other receivables                                | (87,183)    |       |
| Increase in inventory  | (653,410)   |       |
| Increase in construction in progress                         | (448,480)   |       |
| Increase in prepayment and other current assets              | (1,950,812) |       |
| Increase (Decrease) in accounts payable and accrued expenses | 135,000     |       |
| Increase in deferred revenue                                 | 930,900     |       |
| Decrease in other liabilities                                | (38,608)    |       |
|  | -----       | ----- |
| Total Adjustments  | 289,978     |       |
|  | -----       | ----- |
| Net cash used in operating activities                        | (150,372)   |       |
|  | -----       | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES                         |             |       |
| Proceeds from disposal of property, plant and equipment      | 42,843      |       |
| Purchase on investment                                       | --          |       |
| Purchases of property, plant and equipment                   | (1,707,283) |       |
| Decrease (Increase) in deposit                               | 85,075      |       |
| Increase in short-term investments                           | (930,900)   |       |
| Payment on deferred assets                                   | (151,081)   |       |
| Increase in other assets                                     | 103,485     |       |
|  | -----       | ----- |
| Net cash provided by (used in) investing activities          | (2,557,861) |       |
|  | -----       | ----- |

6

CITY NETWORK, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

|   | Six Months Ended June 30, |            |
|---|---------------------------|------------|
|   | 2006                      | 2005       |
|   | -----                     | -----      |
| CASH FLOWS FROM FINANCING ACTIVITIES                |                           |            |
| Proceeds from short-term borrowings                 | \$ 2,153,941              | \$ 3,550,5 |
| Payment on notes payable                            | (1,759,802)               | (4,249,4   |
| Payment of loan from related party                  | (105,125)                 | (6,2       |
| Loan from related party                             | --                        | 26,5       |
| Proceeds from long-term debts                       | 1,582,530                 |            |
|   | -----                     | -----      |
| Net cash provided by (used in) financing activities | 1,871,544                 | (678,7     |
|   | -----                     | -----      |
| Effect of exchange rate change on cash              | 10,991                    | 192,5      |
| Net change in cash and cash equivalents             | (825,698)                 | (1,313,8   |
|   | -----                     | -----      |

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|  |            |          |
|--|------------|----------|
| Cash and cash equivalents at beginning of period | 856,587    | 2,010,6  |
|  | -----      | -----    |
| Cash and cash equivalents at end of period       | \$ 30,889  | \$ 696,7 |
|  | =====      | =====    |
| Supplemental cash flows disclosures:             |            |          |
| Income tax payments                              | \$ --      | \$ 1     |
|  | =====      | =====    |
| Interest payments                                | \$ 116,459 | \$ 81,2  |
|  | =====      | =====    |

7

CITY NETWORK, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

|   | June 30, 2006 | Dece  |
|---|---------------|-------|
|   | -----         | ----- |
|   | (Unaudited)   |       |
| Common stock, number of shares                                      |               |       |
| Balance at beginning of period                                      | 32,967,183    |       |
| Common stock issued   | --            |       |
|   | -----         |       |
| Balance at end of period  | 32,967,183    |       |
|   | =====         |       |
| Treasury stock, number of shares                                    |               |       |
| Balance at beginning of period                                      | 4,445,455     |       |
| Treasury stock acquired   | --            |       |
|   | -----         |       |
| Balance at end of period  | 4,445,455     |       |
|   | =====         |       |
| Common stock, par value \$.001                                      |               |       |
| Balance at beginning of period                                      | \$ 32,967     | \$    |
| Common stock issued   | --            |       |
|   | -----         |       |
| Balance at end of period  | \$ 32,967     | \$    |
|   | =====         |       |
| Additional paid in capital  |               |       |
| Balance at beginning of period                                      | \$ 6,157,479  | \$    |
| Issuance of stock   | --            |       |
| Deemed interest due to warrants issued related to convertible notes | 125,500       |       |
|   | -----         |       |
| Balance at end of period  | \$ 6,282,979  | \$    |
|   | =====         |       |
| Other comprehensive income  |               |       |
| Balance at beginning of period                                      | \$ 366,384    | \$    |
| Foreign currency translation  | 83,990        |       |
|   | -----         |       |
| Balance at end of period  | \$ 450,374    | \$    |
|   | =====         |       |

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|   |                |       |
|---|----------------|-------|
| Retained earnings (deficits)                |                |       |
| Balance at beginning of period              | \$ (1,769,859) | \$    |
| Net income (loss)                           | (440,350)      | -     |
|   | -----          | -     |
| <br>  |                |       |
| Balance at end of period                    | \$ (2,210,209) | \$    |
|   | =====          | =     |
| <br>  |                |       |
| Less: Cost of treasury stock                |                | 0     |
|   |                | ----- |
| <br>  |                |       |
| Total stockholders' equity at end of period | \$ 4,556,111   | \$    |
|   | =====          | =     |

8

CITY NETWORK, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
June 30, 2006  
(UNAUDITED)

NOTE A - ORGANIZATION

City Network, Inc., formerly Investment Agents, Inc., was incorporated on August 8, 1996 under the laws of the State of Nevada. City Network Technology, Inc., formerly Gelcrest Investments Limited, was incorporated under the laws of the British Virgin Islands on March 1, 2002. City Network, Inc. -Taiwan, formerly City Engineering, Inc., was incorporated under the laws of Republic of China on September 6, 1994. City Construction was incorporated under the laws of Republic of China on October 10, 2003. City Network, Inc. owns 100% of the capital stock of City Network Technology, Inc., and City Network Technology, Inc. owns 100% of the capital stock of City Network, Inc. - Taiwan, and City Construction. Collectively the four corporations are referred to herein as the "Company".

The Company designs, manufactures and markets a comprehensive line of broadband communication and wireless Internet access products and solutions. Also, the broadband communication product line includes VOIP, GUI-based remote management and routing technology software packages for simplified setup, extensive network management and global network connectivity capabilities, home PNA and xDSL broadband access equipment, ADSL/VDSL ACCESS DEVICES, HPNA ACCESS DEVICES, FTTB (Fiber to the Building) and FTTH (Fiber to the Home), PCMCIA cards and USB adapters. The other wireless Internet access solutions are used in both individual and corporate.

The Company has also recently begun the development of its construction business. The Company plans to develop and build commercial and residential buildings, industry factory buildings, and professional buildings. The Company has entered co-construction agreements for the development of land in Keelung, Taiwan and the purchase of materials with a company in Vietnam, as further described in Note H herein.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

UNAUDITED INTERIM FINANCIAL INFORMATION

The accompanying financial statements have been prepared by City Network, Inc., pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") Form 10-QSB and Item 310 of Regulation S-B and

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generally accepted accounting principles for interim financial reporting. These financial statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary for a fair presentation of the statement of financial position, operations, and cash flows for the periods presented. Operating results for the six months ended June 30, 2006 and 2005 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006, or any future period, due to seasonal and other factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting policies have been omitted in accordance with the rules and regulations of the SEC. These financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes, included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2005.

9

### NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### REVENUE RECOGNITION

Revenue from sales of products to customers is recognized upon shipment or when title passes to customers based on the terms of the sales, and is recorded net of returns, discounts and allowances. Service income is recognized as the related services are provided pursuant to the terms of the service agreement.

#### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of City Network, Inc., and its wholly owned subsidiaries City Network Technology, Inc. and its wholly owned subsidiaries, City Network, Inc. - Taiwan and City Construction, collectively referred to within as the Company. All material intercompany accounts, transactions and profits have been eliminated in consolidation.

#### FINANCIAL STATEMENT PRESENTATION

Certain changes to the 2005 financial statements have been made to conform to the 2006 financial statement format.

#### RISKS AND UNCERTAINTIES

The Company is subject to substantial risks from, among other things, intense competition from the providers of broadband products, services and the telecommunication industry in general, other risks associated with financing, liquidity requirements, rapidly changing customer requirements, limited operating history, and the volatility of public markets.

#### CONTINGENCIES

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought.



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If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's financial statements. If the assessment indicates that a potential material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material would be disclosed.

Loss contingencies considered to be remote by management are generally not disclosed unless they involve guarantees, in which case the guarantee would be disclosed.

10

### NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain estimates and assumptions that affect the 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. Actual results could differ from those estimates. Significant estimates include collectibility of accounts receivable, accounts payable, sales returns and recoverability of long-term assets.

#### ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company has made an allowance for doubtful accounts for trade receivables based on a combination of write-off history, aging analysis, and any specific known troubled accounts.

#### FIXED ASSETS

Property and equipment are stated at cost less accumulated depreciation. Expenditures for major additions and improvements are capitalized and minor replacements, maintenance and repairs are charged to expense as incurred. Depreciation is provided on the straight-line method over the estimated useful lives of the assets, or the remaining term of the lease, as follows:

|                                |          |
|--------------------------------|----------|
| Furniture and Fixtures         | 5 years  |
| Equipment                      | 5 years  |
| Computer Hardware and Software | 3 years  |
| Building and Improvements      | 50 years |

#### INTANGIBLE ASSETS

Effective July 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." The adoption of SFAS No. 142 required an initial impairment assessment involving a comparison of the fair value of trademarks, patents and other intangible assets to current carrying value. No impairment loss was recognized for the six months period ended June 30, 2006. Trademarks and other intangible assets determined to have indefinite useful lives are not amortized. The Company tests such trademarks and other intangible assets with indefinite useful lives for impairment annually, or more frequently if events or circumstances indicate that an asset might be impaired.

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Trademarks and other intangible assets determined to have definite lives are amortized over their useful lives or the life of the trademark and other intangible asset, whichever is less.

### EXCHANGE GAIN (LOSS)

As of June 30, 2006 and 2005, the transactions of City Network, Inc. - Taiwan and City Construction were denominated in a foreign currency and are recorded in New Taiwan Dollars ("NTD"), at the rates of exchange in effect when the transactions occur. Exchange gains and losses are recognized for the different foreign exchange rates applied when the foreign currency assets and liabilities are settled.

11

### NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### TRANSLATION ADJUSTMENT

The accounts of City Network, Inc. - Taiwan and City Construction were maintained, and their financial statements were expressed, in New Taiwan Dollars (NTD). Such financial statements were translated into U.S. Dollars (USD) in accordance SFAS No. 52, "Foreign Currency Translation", with the NTD as the functional currency. According to the Statement, all assets and liabilities were translated at the current exchange rate, stockholder's equity are translated at the historical rates and income statement items are translated at the weighted average exchange rate for the period. The resulting translation adjustments are reported under other comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income" as a component of shareholders' equity.

As of June 30, 2006 and December 31, 2005 the exchange rates between NTD and the USD were NTD\$1=USD\$0.03067 and NTD\$1=USD\$0.03044, respectively. The weighted-average rates of exchange between NTD and USD were NTD\$1=USD\$0.03103 and NTD\$1=USD\$0.03117 for the period (year) ended June 30, 2006 and December 31, 2005, respectively. Total translation adjustment recognized as of June 30, 2006 and December 31, 2005 is \$450,374 and \$366,384, respectively.

#### FAIR VALUE OF FINANCIAL INSTRUMENTS

Our Company measures its financial assets and liabilities in accordance with generally accepted accounting principles. For certain of the Company's financial instruments, including accounts receivable (trade and related party), notes receivable and accounts payable (trade and related party), and accrued expenses, the carrying amounts approximate fair value due to their short maturities. The amounts owed for long-term debt and revolving credit facility also approximate fair value because interest rates and terms offered to the Company are at current market rates.

#### STATEMENT OF CASH FLOWS

In accordance with SFAS No. 95, "Statement of Cash Flows", cash flows from the Company's operations are based upon the local currencies. As a result, amounts related to assets and liabilities reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheet.

#### CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk are accounts receivable and other

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receivables arising from its normal business activities. The Company has a diversified customer base. The Company controls credit risk related to accounts receivable through credit approvals, credit limits and monitoring procedures. The Company routinely assesses the financial strength of its customers and, based upon factors surrounding the credit risk, establishes an allowance, if required, for un-collectible accounts and, as a consequence, believes that its accounts receivable credit risk exposure beyond such allowance is limited.

### INVENTORY

Inventory is valued at the lower of cost or market. Cost is determined on the weighted average method. As of June 30, 2006, inventory consisted only of finished goods.

12

### NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### PRODUCT WARRANTIES

The Company estimates its warranty costs based on historical warranty claim experience and applies this estimate to the revenue stream for products under warranty. Future costs for warranties applicable to revenue recognized in the current period are charged to cost of revenue. The warranty accrual is reviewed quarterly to verify that it properly reflects the remaining obligation based on anticipated expenditures over the balance of the obligation period. Adjustments are made when accrual warranty claim experience differs from estimate.

#### LONG-TERM EQUITY INVESTMENTS

Long-term equity investments are accounted for by the equity method when the Company and its subsidiaries owns 20% or more of the investee's voting shares, or less than 20% of investee's voting shares but is able to exercise significant influence over the investee's operation and financial policies, but not more than 50%. All other long-term equity investments are accounted for by either the lower-of-cost-or-market method or cost method.

For long-term equity investments accounted for under the equity method related to investee's that are publicly listed companies, unrealized losses resulting from declines in the market value below cost are recorded as a separate component of stockholders' equity.

For long-term equity investments in non-listed companies accounted for under the cost method, investments are stated at original cost. A write-down of the investment balance to earnings is taken only if it is determined that there is a permanent decline in the investment's value. Stock dividends do not result in the recognition of investment income.

For long-term equity investments accounted for by the equity method, the investment is initially recorded at cost, then reduced by dividends and increased or decreased by investor's proportionate share of the investee's net earnings or loss.

#### CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investments purchased with initial maturities of three months or less to be cash equivalents.

#### ADVERTISING

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Advertising costs are expensed in the year incurred.

### INCOME TAXES

Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements.

13

### NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### INCOME TAXES (Continued)

Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled as prescribed in SFAS No. 109, "Accounting for Income Taxes". As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

#### DEFERRED OFFERING COSTS AND DISCOUNT TO CONVERTIBLE NOTES

The Company accounts for offering cost incurred in the private placements as deferred expense and amortizes it over the economic life of these convertible notes. In accordance with APB No. 14, the Company accounts for the fair value of warrants and beneficial conversion feature resulting from issuing convertible notes as discount to these convertible notes and amortizes the discount over the economic life of these convertible notes.

#### EARNINGS PER SHARE

The Company uses SFAS No. 128, "Earnings Per Share", for calculating the basic and diluted earnings (loss) per share. Basic earnings (loss) per share are computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding. Diluted earnings per share are computed similar to basic earnings per share except that the denominator is increased to include common stock equivalents, if any, as if the potential common shares had been issued.

#### IMPAIRMENT OF LONG-LIVED ASSETS AND LONG-LIVED ASSETS TO BE DISPOSED OF

On January 1, 2002 the Company adopted SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets". The Company evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the estimated future cash flows (undiscounted and without interest charges) from the use of an asset were less than the carrying value, a write-down would be recorded to reduce the related asset to its estimated fair value. There have been no such impairments to date.

#### NEW ACCOUNTING PRONOUNCEMENTS

In March 2005, FASB issued FASB Interpretation ("FIN") No. 47, "Accounting for Conditional Asset Retirement Obligations." FIN 47 clarifies that the term "Conditional Asset Retirement Obligation" as used in FASB Statement No. 143, "Accounting for Asset Retirement Obligation," refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Accordingly, an entity is

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required to recognize a liability for the fair value of a Conditional Asset Retirement Obligation if the fair value of the liability can be reasonably estimated. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. Management does not believe the adoption of FIN 47 will have a material affect on the Company's financial position, results of operations or cash flows.

In May 2005, the Financial Accounting Standards Board ("FASB") SFAS No. 154, Accounting Changes and Error Corrections ("SFAS No. 154"), which

14

### NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### NEW ACCOUNTING PRONOUNCEMENTS (Continued)

replaces Accounting Principles Board Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principles. It requires retrospective application to prior periods' financial statements of changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The impact on the Company's operations will depend on future accounting pronouncements or changes in accounting principles.

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006, with earlier adoption permitted. The company is currently evaluating the provisions of FIN 48.

### NOTE C - CONCENTRATION

The Company had three major customers during the six months ended June 30, 2006. Sales to these customers were approximately \$2,705,284. Those customers comprise 85% of the total sales during the six months ended June 30, 2006. Included in accounts receivable is approximately \$1,949,570 from these customers as of June 30, 2006.

### NOTE D - CASH

The Company maintains its cash balances at various banks in Taiwan. The balances are insured by the Central Deposit Insurance Corporation (CDIC) up to approximately \$30,740. As of June 30, 2006, there was \$951,773 in uninsured balances held at these banks.

### NOTE E - COMPENSATING BALANCES

The company, under the terms of its lines of credit with two banks in Taiwan, has agreed to maintain a compensating balance equal to at least 30% to 35% of the outstanding loan balance. As of June 30, 2006, \$1,289,143 of cash is restricted for this purpose (see Note L).

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15

NOTE F - FIXED ASSETS

Fixed assets consist of the following:

|                           | June 30, 2006 | December 31, 2005 |
|---------------------------|---------------|-------------------|
|                           | -----         | -----             |
| Land                      | \$ 3,306,373  | \$ 1,909,023      |
| Building and improvements | 592,684       | --                |
| Other equipment           | 497,580       | 525,077           |
|                           | -----         | -----             |
|                           | 4,396,637     | 2,434,100         |
| Accumulated depreciation  | (223,720)     | (190,886)         |
|                           | -----         | -----             |
|                           | \$ 4,172,917  | \$ 2,243,214      |
|                           | =====         | =====             |

NOTE G - INTANGIBLE ASSETS

Intangible assets consist of the following:

|                          | June 30, 2006 | December 31, 2005 |
|--------------------------|---------------|-------------------|
|                          | -----         | -----             |
| Trademarks               | \$ 2,239      | \$ 2,222          |
| Intangible asset         | 1,073,450     | 1,065,400         |
|                          | -----         | -----             |
|                          | 1,075,689     | 1,067,622         |
| Accumulated amortization | (179,482)     | (142,548)         |
|                          | -----         | -----             |
|                          | \$ 896,207    | \$ 925,074        |
|                          | =====         | =====             |

NOTE H- COMMITMENTS

Reseller Agreements - City Network, Inc. - Taiwan has several signed reseller agreements with various customers. These resellers are given special sales prices and are paid commissions for their sales orders.

Co-Construction Agreements - In April 2004, City Construction Co., Ltd. placed a refundable performance bond in the amount of \$233,092 with the court in Taiwan for the rights to complete an unfinished building in Keelung, Taiwan with the owners of the land. The Company is currently in discussion with the landowners regarding the terms of the project.

16

NOTE H- COMMITMENTS (Continued)

In March 2005, City Construction Co., Ltd. entered a Co-Construction Agreement with three individuals who own a tract of land in Keelung, Taiwan. Under the agreement, the Company will finance, construct and, upon completion, will own 60% of the building project. The Company agreed to make refundable deposits, as security, totaling approximately \$91,320 payable at various agreed upon phases of the construction. The deposits

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will be returned within 2 years after the construction is completed. As of June 30, 2006, the Company has paid \$61,340 as part of the refundable security deposit and \$864,540 as construction in progress on the building.

On July 20, 2005, and as amended on September 22, 2005, the Company entered into a contract with a company in Vietnam. Per the terms of the contract the Company has agreed to procure materials and equipment related to the construction of a commercial building in Vietnam. As of June 30, 2006, the Company received an advance of \$3,000,000 on this contract and is using these funds to purchase the related materials.

On July 25, 2005 the Company entered into a contract with a company in Samoa to purchase materials from them related to the above Vietnam contract. The total purchases will be approximately \$3,000,000. As of June 30, 2006, the Company advanced approximately \$2,740,000 to this vendor.

Operating Leases - The Company leases office facilities under operating leases that terminate on various dates. Rental expense for these leases consisted of \$24,815 for the six months ended June 30, 2006. The Company has future minimum lease obligations as follows:

| Year  | Amount   |
|-------|----------|
| ----- | -----    |
| 2007  | \$22,082 |
| 2008  | 20,242   |
|       | -----    |
| Total | \$42,324 |
|       | =====    |

### NOTE I - LONG-TERM INVESTMENT

On August 31, 2003 the Company purchased approximately twenty-five percent (25%) of Beijing Putain Hexin Network Technology Co., Ltd for \$325,000. On December 4, 2003 the Company purchased an additional fifteen percent (15%) for \$398,500. Beijing Putain Hexin Network Technology Co., Ltd is not publicly traded or listed. The Company is using the complete equity method to record its share of the subsidiary's net income and loss. As of June 30, 2006, the Company recognized a gain of \$47,961 from their acquisition.

### NOTE J - COMPENSATED ABSENCES

Employees earn annual vacation leave at the rate of seven (7) days per year for the first three years. Upon completion of the third year of employment, employees earn annual vacation leave at the rate of ten (10) days per year for years four through five. Upon completion of the fifth year of employment, employees earn annual vacation leave at the rate of fourteen (14) days per year for years six through ten. Upon completion of the tenth year of employment, one (1) additional day for each additional year, until it reaches thirty (30) days per year. At termination, employees are paid for any accumulated annual vacation leave. As of June 30, 2006 vacation liability existed in the amount of \$2,472.

17

### NOTE K - INCOME TAXES

Total Federal and State income tax expense for the six months ended June 30, 2006 and 2005 both amounted to \$0. For the six months ended June 30, 2006 and 2005, there is no difference between the federal statutory tax rate and the effective tax rate.

The following is a reconciliation of income tax expense:

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| 06/30/06 | U.S.  | State | International | Total |
|----------|-------|-------|---------------|-------|
| -----    | ----- | ----- | -----         | ----- |
| Current  | \$ 0  | \$ 0  | \$ 0          | \$ 0  |
| Deferred | 0     | 0     | 0             | 0     |
|          | ----- | ----- | -----         | ----- |
| Total    | \$ 0  | \$ 0  | \$ 0          | \$ 0  |
|          | ===== | ===== | =====         | ===== |

  

| 06/30/05 | U.S.  | State | International | Total  |
|----------|-------|-------|---------------|--------|
| -----    | ----- | ----- | -----         | -----  |
| Current  | \$ 0  | \$ 0  | \$ 178        | \$ 178 |
| Deferred | 0     | 0     | 0             | 0      |
|          | ----- | ----- | -----         | -----  |
| Total    | \$ 0  | \$ 0  | \$ 178        | \$ 178 |
|          | ===== | ===== | =====         | =====  |

Reconciliation of the differences between the statutory U.S. Federal income tax rate and the effective rate is as follows:

|                               | 06/30/06 | 06/30/05 |
|-------------------------------|----------|----------|
|                               | -----    | -----    |
| Federal statutory tax rate    | 34%      | 34%      |
| State, net of federal benefit | 0%       | 0%       |
|                               | -----    | -----    |
| Effective tax rate            | 34%      | 34%      |
|                               | =====    | =====    |

NOTE L - OTHER COMPREHENSIVE INCOME

Balances of related after-tax components comprising accumulated other comprehensive income (loss), included in stockholders' equity, at June 30, 2006 and December 31, 2005 are as follows:

|                              | Foreign Currency<br>Translation Adjustment | Accumulated Other<br>Comprehensive Income |
|------------------------------|--|---|
|                              | -----                                      | -----                                     |
| Balance at December 31, 2004 | \$142,453                                  | \$142,453                                 |
| Change for 2005              | 223,931                                    | 223,931                                   |
|                              | -----                                      | -----                                     |
| Balance at December 31, 2005 | 366,384                                    | 366,384                                   |
| Change for 2006              | 83,990                                     | 83,990                                    |
|                              | -----                                      | -----                                     |
| Balance at June 30, 2006     | \$450,374                                  | \$450,374                                 |
|                              | =====                                      | =====                                     |

NOTE M - CONVERTIBLE NOTES

On June 30, 2006, the Company sold a \$400,000 convertible promissory note to Cornell Capital Partners, LP. The notes bears interest at 7% per annum and will mature two years after issuance. A 20% redemption premium on the principal amount of the Notes is due when they are redeemed, if the closing bid price of the common stock is less than the Fixed Conversion Price. The notes are convertible into Common Stock based on at the lower of (a) \$0.268 per share or (b) 95% of the lowest volume weighted average



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price of the Common Stock, as reported by Bloomberg, LP, for the thirty (30) trading days preceding the conversion. The Company bears \$247,550 of selling expenses. For the six months ended June 30, 2006, the amortization of deferred offering cost was \$0.

In connection with this transaction, the Company issued to Cornell Capital Partners, LP a five-year warrant to purchase 1,000,000 shares of Common Stock at an exercise price of \$0.001 per share. The Company estimated the fair value of the warrant at \$120,000 by using Black-Scholes option pricing model. In accordance with EITF 00-27, the Company allocated the fair value of \$120,000 to the warrant and the fair value of \$280,000 to the convertible notes, in accordance with relative fair value method. Based on the fair value of \$280,000, the Company recognized the beneficial conversion feature of \$0 in accordance with the market price of the Company's common stock on each issuing date. Consequently, the convertible note of \$400,000 had a total discount of \$120,000. As of June 30, 2006, \$0 of the discount related to warrant and \$0 of discount related to beneficial conversion feature have been amortized.

On June 30, 2006, the Company amended and reissued the convertible notes (Original Notes) originally issued to Highgate House Funds, Ltd on August 17, 2005 and December 16, 2005 in the aggregate principal amount of \$250,000. Each note bears interest at 7% per annum and will mature two years after issuance.

The above notes are secured by substantially all of the assets of the Company and its direct and indirect wholly-owned subsidiaries, City Technology, Inc., City Network, Inc.--Taiwan and City Construction Co., Ltd.

19

### NOTE N - SHARE-BASED PAYMENTS

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R. The Company recognized the share-based compensation cost based on the grant-date fair value estimated in accordance with the new provisions of SFAS No. 123R. As of June 30, 2006, the Company had outstanding warrants to purchase 1,025,000 shares with an exercise price of \$0.001 per share.

The fair value for the share-based awards was estimated using the Black-Scholes option pricing model with the assumptions listed below:

|                             | June 30,       |       |
|-----------------------------|----------------|-------|
|                             | 2006           | 2005  |
|                             | -----          | ----- |
| Expected volatility         | 47.66 - 81.79% | --%   |
| Weighted average volatility | 47.66 - 81.79% | --%   |
| Expected life (years)       | 3.0 - 5.0      | --    |
| Risk free interest rate     | 3.55 - 4.69%   | --%   |

A summary of stock warrants for the six months ended June 30, 2006 is presented as follows:

| Stock Warrants | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (Months) |
|----------------|--------|---------------------------------|--|
| -----          | -----  | -----                           | -----  |
|                |        |                                 |  |

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|                                |           |          |       |
|--------------------------------|-----------|----------|-------|
| Outstanding at January 1, 2006 | 25,000    | \$ 0.001 | 19.33 |
| Granted                        | 1,000,000 | 0.001    | 60.00 |
| Exercised                      | --        |          |       |
| Forfeited or expired           | --        |          |       |
|                                | -----     | -----    | ----- |
| Outstanding at June 30, 2006   | 1,025,000 | 0.001    | 53.00 |
|                                | =====     | =====    | ===== |
| Exercisable at June 30, 2006   | 1,025,000 | \$ 0.001 | 53.00 |
|                                | =====     | =====    | ===== |

20

NOTE O - DEBT

At June 30, 2006 and December 31, 2005, the Company had notes payable outstanding in the aggregate amount of \$6,786,577 and \$4,792,898, respectively. The notes are secured by the Company real properties and time deposits, payable as follows:

| June 30, 2006<br>-----  | December 31, 2005<br>-----  |
|---|---|
| Note payable to a bank in Taiwan, interest at 3.838% per annum, due by October 8, 2006  | Note payable to a bank in Taiwan, interest at 3.838% per annum, due by October 8, 2006    |
| \$ 490,720  |   |
| Note payable to a bank in Taiwan, interest at 3.838% per annum, due by August 31, 2006  | Note payable to a bank in Taiwan, interest at 3.838% per annum, due by August 31, 2006    |
| 920,100   |   |
| Note payable to a bank in Taiwan, interest at 3.838% per annum, due by January 12, 2007 | Note payable to a bank in Taiwan, interest at 5.906% per annum, due by September 28, 2006 |
| 122,680   |   |
| Note payable to a bank in Taiwan, interest at 3.894% per annum, due by April 11, 2006   | Note payable to a bank in Taiwan, interest at 3.838% per annum, due by January 27, 2006   |
| 260,783   |   |
| Note payable to a bank in Taiwan, interest at 3.30% per annum, due by April 4, 2021     | Note payable to a bank in Taiwan, interest at 3.838% per annum, due by February 3, 2006   |
| 1,564,170   |   |
| Note payable to a bank in Taiwan, interest at 3.838% per annum, due by June 16, 2007    | Note payable to a bank in Taiwan, interest at 3.838% per annum, due by February 3, 2006   |
| 422,976   |   |
| Note payable to a bank in Taiwan, interest at 3.838% per annum, due by June 22, 2007    | Note payable to a bank in Taiwan, interest at 3.838% per annum, due by February 17, 2006  |
| 205,000   |   |
| Note payable to a bank in Taiwan, interest at 3.838% per annum, due by July 13, 2006    | Note payable to a bank in Taiwan, interest at 3.838% per annum, due by February 21, 2006  |
| 63,101  |   |
| Note payable to a bank in Taiwan, interest at 3.894% per annum, due by August 4, 2006   | Note payable to a bank in Taiwan, interest at 3.838% per annum, due by February 25, 2006  |
| 396,005   |   |
| Note payable to a bank in Taiwan,   | Note payable to a bank in Taiwan  |

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|  |           |   |
|--|-----------|---|
| interest at 4.200% per annum, due by<br>January 24, 2012                             | 1,534,729 | interest at 3.838% per annum, du<br>by March 3, 2006                                      |
| Note payable to a corporation in<br>Taiwan, no interest, due by February<br>10, 2010 | 484,985   | Note payable to a bank in Taiwan<br>interest at 3.838% per annum, du<br>by March 24, 2006 |

21

|   |                       |   |
|---|-----------------------|---|
| Usance letter of credit payable to a<br>bank in Taiwan, interest at 6.68% per<br>annum, due by September 21, 2006 | 122,592               | Note payable to a bank in Taiwan<br>interest at 3.838% per annum, du<br>by April 1, 2006    |
| Usance letter of credit payable to a<br>bank in Taiwan, interest at 6.68% per<br>annum, due by September 22, 2006 | 159,719               | Note payable to a bank in Taiwan<br>interest at 3.838% per annum, du<br>by April 21, 2006   |
| Usance letter of credit payable to a<br>bank in Taiwan, interest at 6.68% per<br>annum, due by September 27, 2006 | 39,017                | Note payable to a bank in Taiwan<br>interest at 3.838% per annum, du<br>by April 28, 2006   |
|   |                       | Note payable to a bank in Taiwan<br>interest at 3.838% per annum, du<br>by January 17, 2006 |
|   |                       | Note payable to a corporation i<br>Taiwan, no interest, due b<br>February 10, 2010          |
| Total   | -----<br>6,786,577    |   |
| Current portion   | \$ 4,737,422<br>----- |   |
| Long-term portion   | \$ 2,049,155<br>===== |   |

NOTE P - RELATED PARTY TRANSACTIONS

Throughout the history of the Company, certain members of the Board of Directors and general management have made loans to the Company to cover operating expenses or operating deficiencies.

Andy Lai - As of June 30, 2006, the Company has a non interest-bearing loan from Andy Lai, a former shareholder of the Company, in the amount of \$12,716.

Stella Tseng - As of June 30, 2006, the Company has a non interest-bearing loan from Stella Tseng, a shareholder of the Company, in the amount of \$980,379.

NOTE Q - FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of cash and cash equivalents, accounts receivable, deposits and accounts payable approximate their fair value because of the short maturity of those instruments.

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The carrying amounts of the Company's long-term debt approximate their fair value because of the short maturity and/or interest rates which are comparable to those currently available to the Company on obligations with similar terms.

22

### NOTE R - SEGMENT REPORTING

The Company has two principal operating segments which are (1) the production of broadband communication and wireless Internet access products, (2) other, including building constructions and procurement of material and equipment related to construction. These operating segments were determined based on the nature of the products offered. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. The Company's chief executive officer and chief financial officer have been identified as the chief operating decision makers. The Company's chief operating decision makers direct the allocation of resources to operating segments based on the profitability, cash flows, and other measurement factors of each respective segment.

The Company has determined that broadband communication and wireless Internet access products is a reportable segment as they meet the quantitative thresholds under Financial Accounting Standards Board Statement No. 131 (Disclosures about Segments of an Enterprise and Related Information).

The Company evaluates performance based on several factors, of which the primary financial measure is business segment income before taxes. The Company's construction operating segment is currently in the development stage and has no revenues. The accounting policies of the business segments are the same as those described in "Note A: Summary of Significant Accounting Policies." The table on the following page shows the operations of the Company's reportable segments:

| Six Months Ended June 30, 2006<br>----- | Broadband<br>communication<br>and wireless<br>Internet access<br>products<br>----- | Other (1)<br>----- | Consolidated<br>----- |
|---|--|--------------------|-----------------------|
| Sales to unaffiliated customers         | \$ 3,178,320   | \$ -0-             | \$ 3,178,820          |
| Intersegment sales                      | -0-  | -0-                | -0-                   |
| Net sales                               | 3,178,320  | -0-                | 3,178,820             |
| Income (loss) before taxes              | (14,927)   | (425,423)          | (440,350)             |
| Total assets (2)                        | 11,116,041   | 7,434,532          | 18,550,573            |
| Property additions (3)                  | 1,697,974  | 9,309              | 1,707,283             |
| Interest expense                        | 103,851  | 18,108             | 121,959               |
| Interest revenue                        | 1,181  | 17,470             | 18,651                |
| Depreciation and amortization (3)       | 96,521   | -0-                | 96,521                |

23

### NOTE S - SEGMENT REPORTING (Continued)

(1) Revenue from segments below the quantitative thresholds is

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attributable to two operating segments of the Company. Those segments include building constructions and procurement of material and equipment related to construction. None of those segments has ever met any of the quantitative thresholds for determining reportable segments.

- (2) Total business assets are the owned or allocated assets used by each business. Corporate assets consist of cash and cash equivalents, unallocated fixed assets of support divisions and common facilities, and certain other assets.
- (3) Corporate property additions and depreciation and amortization expense include items attributable to the unallocated fixed assets of support divisions and common facilities.

Also, because all of the Company's sales are derived from the sales of products outside of the United States, all long-lived assets are located outside the United States.

### NOTE T - LEGAL PROCEEDINGS

The Company is party to certain litigation that has arisen in the normal course of its business and that of its subsidiary.

Hwa-Ching - In August 2004, a customer closed business and did not pay the remaining balance due to City Network - Taiwan on outstanding receivables in the amount of NT\$27,313,003 or US\$837,690. City Network - Taiwan has filed criminal and civil litigation against the customer for fraud. The Company has recorded a reserve against this account in the amount of \$670,152. This case is currently ongoing.

In August 2004, City Network Inc.-Taiwan filed a lawsuit against the owner of Hwa-Ching Co., as well as the following eight individuals in Taiwan, alleging fraud for closing down Hwa-Ching Co. without payment for the delivered merchandise. City Network Inc.-Taiwan sought approximately NT\$27 million or approximately US\$830,000. In January 27 2006, the court reached a verdict and found three individuals guilty of fraud and another two individuals not guilty. In connection with the litigation against the other three individuals, the court has not yet reached a verdict.

In December 2004, the Company filed a lawsuit against Tain-Kang Co., a customer of Hwa-Ching Co. in Taipei District Court claiming damages owed to Hwa-Ching from Tain-Kang in the amount of approximately NT\$5,796,000 or US\$178,169 to cover the outstanding account payable owed by Hwa-Ching to the Company. In November 2005, Taipei District Court reached judgment in favor of defendant. The Company filed appeal to Taiwan High Court. During the appeal, the Company reduced the claimed amount to NT\$3,796,000 or US\$116,689 after Tain-Kang provided proof of payments of NT\$2,000,000. To date, the court has not yet ruled on this case.

On October 10, 2004, RPPI International Ltd. (or Rong-Dian), a vendor of the Company, filed a lawsuit against City Network Inc.-Taiwan in the Taiwan Taipei district court of Taiwan, in Taipei, Taiwan, alleging breach of contract for two different purchase agreements that City Network Inc.-Taiwan entered with them and two third parties. Rong-Dian sought the aggregate amount of approximately NT\$40.2 million or US\$1.2 million for the alleged breaches. One purchase agreement was for an order that City Network Inc.-Taiwan sold to Hwa-Ching Co. in the amount of approximately

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NT\$27.3 million or US\$840,000 and the other purchase agreement was for an order City Network Inc.-Taiwan sold to a separate customer of the Company in the amount of approximately NT\$12.9 million or US\$396,546.

On June 21, 2005, City Network Inc.-Taiwan entered a settlement agreement with Rong-Dian, and on June 29, 2005, the district court lifted the lawsuit against us. In the June 2005 settlement agreement, City Network Inc.-Taiwan agreed to pay Rong-Dian a total of approximately NT\$40.2 million or US\$1.2 million, to cover the full amount City Network Inc.-Taiwan owed under the two purchase agreements. In August 2005, City Network Inc.-Taiwan paid Rong-Dian approximately NT\$12.9 million or US\$390,909 of the total amount owed upon receipt of such amount from our customer. City Network Inc. - Taiwan intends to pay the balance of approximately NT\$27.3 million or US\$840,000 to Rong-Dian in 54 separate checks, issued and payable by Tai-Wang Technology Co., Ltd. These checks will be in increments of NT\$500,000 or US\$15,370 and payable for 53 consecutive months, beginning on August 10, 2005 with the last and 54th payment being in the amount of NT\$813,003 or US\$24,992. As of June 30, 2006, approximately NT\$4 million, or approximately US\$168,685, has been paid on this liability.

Pursuant to the June 2005 settlement agreement, City Network Inc.-Taiwan agreed to pay Rong-Dian the balance of NT\$27.3 million in monthly payments. However, as a result of its relationship with Tai-Wang and the fact that Tai-Wang is the vendor who introduced City Network Inc.-Taiwan to Rong-Dian, Tai-Wang assumed the responsibility for the payment of NT\$27.3 million or US\$827,272 to Rong-Dian. Tai-Wang wrote each monthly check in advance and thereafter provided all 54 checks to Rong-Dian. Rong-Dian will cash one check each month until it receives payment of the full NT\$27.3 million. However, as Tai-Wang has no written obligation with City Network Inc.-Taiwan to make each monthly payment, beyond an oral promise to do so, there is no assurance that each monthly check will be properly cashed by Rong-Dian. Therefore the Company continues to report the total liability to Rong-Dian. As each payment is successfully paid by Tai-Wang the Company will reduce the liability accordingly and recognize other income as the benefit provided by Tai-Wang.

Additionally, as part of the June 2005 settlement agreement, we secured our obligation that Tai-Wang would pay Rong-Dian the outstanding balance of NT\$27.3 million or US\$827,272 by giving Rong-Dian a first priority mortgage on certain property including lots 701-4 and 701-6 in Jay-hou-xiao-duan, Xi-zhi Duan, Xixhi City, Taipei County, Taiwan. The value of the first priority mortgage on the property is approximately NT\$27.3 million or US\$827,272, the aggregate amount owed to Rong-Dian. City Network Inc.-Taiwan agreed with Rong Dian that this mortgage will expire in 2010.

Shanghai Bank - On January 24, 2005, Shanghai Commercial and Savings Bank ("Shanghai Bank") filed a lawsuit with the Taipei District Court against the Company claiming approximately NT\$12 million or approximately US\$387,000 for the payment of an unpaid purchase price for goods. The Company purchased such goods from Chin Shin and Chin Shin assigned the account receivable to Shanghai Bank. As such, Shanghai Bank sued the Company for the payment of those goods. However, the Company returned the said goods because they were defective.

On November 24, 2005, the Company entered a settlement agreement with Shanghai Bank and the district court lifted the lawsuit against the Company. In the settlement agreement, City Network Inc.-Taiwan agreed to pay Shanghai Bank a total of NT\$5,100,000 or US\$ 155,244. In December 2005, City Network, Inc.-Taiwan paid Shanghai Bank NT\$1,100,000 or

NOTE T - LEGAL PROCEEDINGS (Continued)

US\$33,484. City Network, Inc.- Taiwan intends to pay the balance of NT\$4,000,000 or US\$121,760 to Shanghai Bank in 4 separate checks. These checks will be payable each 2 months, beginning on February 25, 2006. As of June 30, 2006, NT\$4,100,000 or US \$125,747 has been paid on this liability.

NOTE R- GOING CONCERN

The Company has suffered recurring losses from operations, cash deficiencies and the inability to meet its maturing obligations without borrowing from related parties and restructuring debts. These issues may raise substantial concern about its ability to continue as a going concern.

Management has prepared the following statement to address these and other concerns:

The Company is currently engaged in discussions with a number of companies regarding strategic acquisitions or potential financings. Although these discussions are ongoing, there can be no assurance that any of these discussions will result in actual acquisitions or a completed financing for the Company.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

The following discussion should be read in conjunction with the Consolidated Financial Statements and Notes thereto appearing elsewhere in this Form 10-QSB. The information in this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties, including statements regarding our capital needs, business strategy and expectations, including but not limited to the following:

- \* our ability to raise funds in the future through public or private financings;
- \* the timing of our introduction of products or product enhancements;
- \* our ability to manage costs associated with our product or technology acquisitions;
- \* our ability to keep pace with rapidly changing technology, evolving industry standards and new product and services in our industry;
- \* customers' acceptance of our product designs;
- \* our ability to integrate businesses, products and technologies and in joint ventures and strategic relationships with other companies;

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- \* our business expenses being greater than anticipated due to competitive factors or unanticipated developments;
- \* changes in political and economic conditions in the Asian and European countries where we do business;
- \* our ability to retain management and key personnel;
- \* our ability to protect our developed technologies, know-how, trademarks and related intellectual properties; and
- \* our ability to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may", "will", "should", "expect", "plan", "intend", "anticipate", "believe", estimate", "predict", "potential" or "continue", the negative of such terms or other comparable terminology. Actual events or results may differ materially. We disclaim any obligation to publicly update these statements, or disclose any difference between its actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

27

### BACKGROUND OF THE COMPANY

City Network, Inc., formerly Investment Agents, Inc., was incorporated on August 8, 1996 under the laws of the State of Nevada. City Network Technology, Inc., formerly Gelcrest Investments Limited, was incorporated under the laws of the British Virgin Islands on March 1, 2002. City Network, Inc. - Taiwan, formerly City Engineering, Inc., was incorporated under the laws of Republic of China on September 6, 1994. City Construction Co., Ltd. was incorporated under the laws of Republic of China on October, 10, 2003. City Network, Inc. owns 100% of the capital stock of City Network Technology, Inc., and City Network Technology, Inc. owns 100% of the capital stock of City Network, Inc. - Taiwan and City Construction. Collectively the four corporations are referred to herein as the "Company".

The Company designs, manufactures and markets a comprehensive line of broadband communication and wireless Internet access product and solutions. Also, the broadband communication product line includes VOIP, GUI-based remote management and routing technology software packages for simplified setup, extensive network management and global network connectivity capabilities, Home PNA and xDSL broadband access equipment, ADSL/VDSL ACCESS DEVICES, HPNA ACCESS DEVICES, FTTB (Fiber to the Building) and FTTH (Fiber to the Home), PCMCIA cards and USB adapters. The other wireless internet access solutions are used in both individual and corporate settings.

In addition, the Company plans to develop and build commercial and residential buildings, industry factory buildings, and professional buildings. The Company has entered co-construction agreements for the development of land in Keelung, Taiwan and the purchase of materials with a company in Vietnam, as further described in Part I herein, in the notes to the financial statements.

The Company has also focused on the sales of LCD panels.

On December 16, 2004, the Company changed its fiscal year end from February 28 to December 31.



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We have suffered recurring losses from operations, cash deficiencies and the inability to meet our maturing obligations without borrowing from related parties and restructuring debts. These issues may raise substantial concern about our ability to continue as a going concern.

We are currently engaged in discussions with a number of companies regarding strategic acquisitions or potential financings. Although these discussions are ongoing, there can be no assurance that any of these discussions will result in actual acquisitions or a completed financing for us.

### CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial conditions and results of operations is based upon our financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP"). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. See "Summary of Significant Accounting Policies" in the Notes to Consolidated Financial Statements in Item to this Report for our critical accounting policies. No significant changes in our critical accounting policies have occurred since December 31, 2004.

28

### RESULTS OF OPERATIONS

#### THREE MONTHS ENDED JUNE 30, 2006 COMPARED WITH THREE MONTHS ENDED JUNE 30, 2005

**NET SALES.** Net sales for the three months ended June 30, 2006 were \$597,758 compared to \$3,599,366 for the three months ended June 30, 2005. The decrease in net sales for the three months ended June 30, 2006 was due to a decrease in demand for our products.

**COST OF SALES.** Cost of sales for the three months ended June 30, 2006 was \$452,463 or 75.7% of net sales, as compared to \$3,377,970 or 93.8% of net sales, during the three months ended June 30, 2005. The decrease was due to the decrease of net sales. The decrease in the cost of sales as a percentage of revenue was due to increased sales of higher-margin products.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses were \$534,576 or 89.4% of net sales, for the three months ended June 30, 2006, as compared to \$376,241 or 10.5% of net sales, for the three months ended June 30, 2005. The increase was due to an increase in professional expenses. The increase in general and administrative expenses as a percentage of net sales is due to the decrease of sales and fixed overhead that cannot readily be reduced, including salary, rent, and depreciation.

**LOSS FROM OPERATIONS.** Loss from operations for the three months ended June 30, 2006 was \$(389,281), compared to loss from operations for the three months ended June 30, 2005 of \$(154,845). The increase in loss from operations for the three months ended June 30, 2006 compared with loss from operations for the three months ended June 30, 2005 resulted primarily from reasons primarily described above.

**OTHER (INCOME) EXPENSE.** Other (income) expense was \$(54,459) for the three months ended June 30, 2006, as compared to \$(35,303) for the three months ended June 30, 2005. This change was the result of the increase of equity in earnings of investee.

**NET LOSS.** Net loss for three months ended June 30, 2006 was \$(334,822)

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compared to net loss of \$(119,720) for the three months ended June 30, 2005. The change in net loss was due to the reasons described above.

### SIX MONTHS ENDED JUNE 30, 2006 COMPARED WITH SIX MONTHS ENDED JUNE 30, 2005

**NET SALES.** Net sales for the six months ended June 30, 2006 were \$3,178,820 compared to \$4,892,716 for the six months ended June 30, 2005. The decrease in net sales for the six months ended June 30, 2006 was due to a decrease in demand for our products.

**COST OF SALES.** Cost of sales for the six months ended June 30, 2006 was \$2,852,618 or 89.7% of net sales, as compared to \$4,633,010 or 94.7% of net sales, during the six months ended June 30, 2005. The decrease in cost of sales is associated with the decrease in sales. The decrease in the cost of sales as a percentage of revenue was due to increased sales of higher-margin products.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses were \$893,469, or 28.1% of net sales, for the six months ended June 30, 2006, as compared to \$699,386, or 14.3% of net sales, for the six months ended June 30,

29

2005. The increase was due to an increase in professional expenses. The increase in general and administrative expenses as a percentage of net sales is due to the decrease of sales and fixed overhead that cannot readily be reduced, including salary, rent, and depreciation.

**INCOME (LOSS) FROM OPERATIONS.** Loss from operations for the six months ended June 30, 2006 was \$(567,267), compared to income from operations for the six months ended June 30, 2005 of \$(439,680). The loss from operations for the six months ended June 30, 2006 compared with income from operations for the six months ended June 30, 2005 was due to a decrease in sales without a proportionate decrease in the cost of sales and general and administrative expenses.

**OTHER (INCOME) EXPENSE.** Other (income) expense was \$(126,917) for the six months ended June 30, 2006, as compared to \$703,748 for the six months ended June 30, 2005. This change was the result of the increase of equity in earnings of investee, commission income and other income, and the decrease in reserve for bad debt.

**NET LOSS.** Net loss for six months ended June 30, 2006 was \$(440,350) compared to income of \$(1,143,606) for the six months ended June 30, 2005. The net loss for the six months ended June 30, 2006 compared with income for the six months ended June 30, 2005 was due to the reasons described above.

### LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2006 and December 31, 2005, we had cash and cash equivalents of \$30,889 and \$856,587, respectively. Our current assets totaled \$10,553,083 at June 30, 2006 as compared to \$9,639,735 at December 31, 2005. Our total current liabilities were \$11,415,307 at June 30, 2006 as compared to \$10,272,005 at December 31, 2005. Working capital at June 30, 2006 was \$(862,224) and \$(632,270) at December 31, 2005. For the six months ended June 30, 2006, total cash used in operations was \$(150,372) as compared to net cash provided by operations of \$(890,388) during the same period in 2005. Net cash provided by financing activities was \$1,871,544, which consisted of loans, as compared with net cash used in financing activities of \$(678,702) during the six months ended June 30, 2005.

### WORKING CAPITAL REQUIREMENTS

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Our operations and short term financing do not currently meet our cash needs. We currently are engaged in discussions with a number of companies regarding strategic acquisitions or investments. Although these discussions are ongoing, there can be no assurance that any of these discussions will result in actual acquisitions or investment. Several potential investors have already shown their interest to invest in our company.

### FACTORS THAT INTERRUPT OUR OPERATIONS

Our major risk is incurring a large amount of bad debt. Our short-term and long-term liquidity may be influenced by uncollected account receivables. If the amount of bad debt is high, it will severely affect our ability to continue operations. Therefore, we are taking precautions to manage this risk, such as preparing accounts receivable aging reports each week and collecting the overdue invoices. We will try to diversify our customer base and control credit risk related to accounts receivable through credit approvals, credit limits and

30

monitoring procedures. Although we have already taken these measures, it is still possible to incur a large amount of bad debt.

Financial instruments that potentially subject us to concentrations of credit risk are cash, accounts receivable and other receivables arising from its normal business activities. We place our cash in what we believe to be credit-worthy financial institutions. We have a diversified customer base, most of which are related parties. We control credit risk related to accounts receivable through credit approvals, credit limits and monitoring procedures. We routinely assess the financial strength of our customers and, based upon factors surrounding the credit risk, establish an allowance, if required, for un-collectible accounts and, as a consequence, believe that our accounts receivable credit risk exposure beyond such allowance is limited.

**CAPITAL EXPENDITURES.** Total capital expenditures during the six months ended June 30, 2006 were \$1,707,283 compared to \$194,717 for the six months ended June 30, 2005.

**CONSTRUCTION.** The Company has begun the development of its construction business. The Company plans to develop and build commercial and residential buildings, industry factory buildings, and professional buildings.

### OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements.

### ITEM 3. CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company's management, including our Chief Executive Officer and the Chief Financial Officer, the Company conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report (the "Evaluation Date"). Based on this evaluation, our Chief Executive Officer and the Chief Financial Officer concluded as of the Evaluation Date that the Company's disclosure controls and procedures were effective such that the material information required to be included in our SEC reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms relating to the Company, including our consolidating subsidiaries, and was made known to them by others within those entities, particularly during the period when this report was being prepared.

## PART II - OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

## HWA-CHING CO. AND RELATED LAWSUITS

In April 2004, Hwa-Ching Co. made purchases from City Network Inc.-Taiwan for products in the aggregate amount of approximately NT\$19 million or US\$575,757. In June 2004, Hwa-Ching Co. wrote a check to City Network Inc.-Taiwan paying for such products and City Network Inc.-Taiwan successfully cashed this check. Also in June 2004, Hwa-Ching Co. made purchases from City Network Inc.-Taiwan for additional products in the aggregate amount of approximately NT\$18 million or US\$545,454 and paid for such products with a check that City Network Inc.-Taiwan also successfully cashed.

During June to August 2004, Hwa-Ching Co. requested additional products from City Network Inc.-Taiwan in the aggregate amount of approximately NT\$27 million or US\$818,181. City Network Inc.-Taiwan filled these orders with confidence as Hwa-Ching had paid for the prior orders from April 2004 and June 2004. However, the check, in the amount of approximately NT\$27 million or US\$818,181 that Hwa-Ching Co. wrote to City Network, Inc.-Taiwan bounced upon deposit with the bank. Immediately thereafter, Hwa-Ching Co. closed down with this remaining account payable balance of approximately NT\$27 million or US\$818,181 outstanding and payable to City Network Inc.-Taiwan.

In August 2004, City Network Inc.-Taiwan filed a lawsuit against Yune-Chang Tsuo, the owner of Hwa-Ching Co., as well as the following eight individuals including, Yong-Zhang Zhuo, Shu-Tao Lu, Yong-Yi Zhuo, Zhuan-Xuan Dai, Ya-Hui Qiu, Mei-Zhen Huang, Zong-Ya Wu, Yao-Guo Cen in Taiwan Taipei district court of Taiwan, in Taipei, Taiwan, alleging fraud for closing down Hwa-Ching Co. without payment for the delivered merchandise. City Network Inc.-Taiwan sought approximately NT\$27 million or approximately US\$900,000 from Yune-Chang Tsuo to cover the outstanding account payable. To date, the court has not yet reached a verdict on this case.

In December 2004, the Company filed a lawsuit against Tain-Kang Co., a customer of Hwa-Ching Co. in Taipei District Court claiming damages owed to Hwa-Ching from Tain-Kang in the amount of approximately NT\$5,796,000 or US\$178,169 to cover the outstanding account payable owed by Hwa-Ching to the Company. In November 2005, Taipei District Court reached judgment in favor of defendant. The Company filed appeal to Taiwan High Court. During the appeal, the Company reduced the claimed amount to NT\$3,796,000 or US\$116,689 after Tain-Kang provided proof of payments of NT\$2,000,000. To date, the court has not yet ruled on this case.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

## ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits:

| No.<br>--- | Description<br>-----  |
|------------|---|
| 31.1       | Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.     |
| 31.2       | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith. |
| 32.1       | Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350 (Section 906 of the Sarbanes-Oxley Act of 2002), filed herewith.  |
| 32.2       | Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350 (Section 906 of the Sarbanes-Oxley Act of 2002), filed herewith.  |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CITY NETWORK, INC.

Dated: August 21, 2006

By: /s/ Alice Chen

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 Alice Chen  
 Chief Executive Officer  
 (Principal Executive Officer)

Dated: August 21, 2006

By: /s/ Yun-Yi Tseng

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 Yun-Yi Tseng  
 Chief Financial Officer  
 (Principal Financial Officer)