Exhibit "A"

Financial Statements

BUTTERFLY FITNESS, INC.

(A California Corporation)

FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005

BUTTERFLY FITNESS, INC.

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RINA accountancy corporation
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RINA

Independent Auditors' Report

The Board of Directors
and Shareholders
Butterfly Fitness, Inc.

We have audited the accompanying balance sheet of Butterfly Fitness, Inc. (a California corporation), as of September 30, 2006 and September 30, 2005, and the related statements of income and stockholders' equity and cash flows for the year ended September 30, 2006 and for the nine months ended September 30, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Butterfly Fitness, Inc. in conformity with accounting principles generally accepted in the United States of America.

RINA accountancy corporation

Certified Public Accountants

Walnut Creek, California
November 22, 2006

BUTTERFLY FITNESS, INC

BALANCE SHEET

ASSETS	September 30, 2006		September 30, 2005	
CURRENT:				
Cash and cash equivalents		$ 1,480,007		$ 253,314
Accounts receivable		47,559		2,376
Prepaid expenses		57,571		32,969
Prepaid advertising		585,399		0
Inventory		30,464		9,892
Deferred taxes		58,000		88,000
TOTAL CURRENT ASSETS		2,259,000		386,551
PROPERTY AND EQUIPMENT, at cost	$ 111,710		$ 28,683	
Less: accumulated depreciation	15,487	96,223	6,419	22,264
OTHER:				
Video and other master production costs, net of accumulated amortization		56,498		112,995
Deferred taxes		9,000		11,000
		$ 2,420,721		$ 532,810

See notes to financial statements.

EXHIBIT A

LIABILITIES	September 30, 2006		September 30, 2005	
CURRENT:				
Accounts payable		$ 249,463		$ 115,148
Accrued liabilities		187,177		70,001
Deferred rent		0		112,268
Deferred revenue		403,000		0
Retirement plan contribution		219,391		0
TOTAL LIABILITIES (All current)		1,059,031		297,417
STOCKHOLDERS' EQUITY				
CAPITAL STOCK:				
Common stock, no par value, 1,000,000 shares authorized; 126,000 issued and outstanding	$ 805,246		$ 805,246	
Paid in capital	126,341	931,587	126,341	931,587
RETAINED EARNINGS (DEFICIT) (EXHIBIT C)		430,103		(696,194)
		$ 2,420,721		$ 532,810

EXHIBIT B

BUTTERFLY FITNESS, INC.

STATEMENT OF INCOME

	Year Ended September 30, 2006	Nine Months Ended September 30, 2005
REVENUE:		
Initial franchise fees	S 5,178,250	S 838,500
Monthly royalty fees	285,400	134,160
Other revenues	65,272	83,321
TOTAL REVENUE	5,528,922	1,055,981
OPERATING EXPENSES:		
Salaries and related costs	1,421,606	477,551
Advertising	968,399	87,155
Professional fees	426,339	177,404
Commissions	389,278	56,450
Travel and client development	351,277	41,121
Rent	227,535	161,997
Office operations	199,610	67,729
Depreciation and amortization	65,566	46,676
Insurance	37,936	4,342
Franchise equipment	18,034	107,668
Miscellaneous	39,192	16,359
TOTAL OPERATING EXPENSES	4,144,772	1,244,453
INCOME (LOSS) FROM OPERATIONS	1,384,150	(188,472)
OTHER INCOME (EXPENSES):		
Administrative reimbursement from affiliate	0	49,886
Interest expense	(5,310)	(28,223)
Pension Plan Contribution	(219,391)	0
TOTAL OTHER INCOME (EXPENSES)	(224,701)	21,663
INCOME (LOSS) BEFORE INCOME TAXES	1,159,449	(166,809)
PROVISION (RECOVERY) FOR INCOME TAXES	33,152	(98,200)
NET INCOME (LOSS)	S 1,126,297	S (68,609)

See notes to financial statements.

EXHIBIT C

BUTTERFLY FITNESS, INC.

STATEMENT OF STOCKHOLDERS' EQUITY

	Common Shares		Common Amount		Additional Paid in Capital		Retained Earnings (Deficit)		Total
Balance, December 31, 2004	114,000	$	150,000	$	0	$	(627,585)	$	(477,585)
Income (loss)							(68,609)		(68,609)
Shares issued	12,000		200,000						200,000
Debt converted to capital			455,246		126,341				581,587
Balance, September 30, 2005	126,000		805,246		126,341		(696,194)		235,393
Income							1,126,297		1,126,297
Balance, September 30, 2006	126,000	$	805,246	$	126,341	$	430,103	$	1,361,690

See notes to financial statements.

BUTTERFLY FITNESS, INC.

STATEMENT OF CASH FLOWS

	Year Ended September 30, 2006		Nine Months Ended September 30, 2005	
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income (loss) (Exhibit B)		$ 1,126,297		$ (68,609)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:				
Depreciation and amortization	$ 65,566		$ 46,676	
Deferred income taxes	32,000		(99,000)	
Decrease (increase) in:				
Accounts receivable	(45,183)		10,112	
Prepaid expenses	(610,002)		(5,422)	
Other assets	(20,572)		1,013	
Increase (decrease) in:				
Accounts payable	134,313		71,430	
Interest payable	0		26,451	
Accrued expenses	(470)		(14,108)	
Accrued salaries and benefits	317,389		(3,791)	
Accrued commissions	19,650		8,250	
Deferred revenue	403,000		0	
Deferred rent	(112,268)	183,423	(29,734)	11,877
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		1,309,720		(56,732)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchase of property and equipment	(83,027)		0	
NET CASH USED BY INVESTING ACTIVITIES		(83,027)		0
CASH FLOWS FROM FINANCING ACTIVITIES:				
Issuance of common stock	0		215,000	
Debt proceeds - short term	0		78,000	
NET CASH PROVIDED BY FINANCING ACTIVITIES		0		293,000
NET INCREASE IN CASH		1,226,693		236,268
CASH AND CASH EQUIVALENTS, beginning of period		253,314		17,046
CASH AND CASH EQUIVALENTS, end of period		$ 1,480,007		$ 253,314

See notes to financial statements.

BUTTERFLY FITNESS, INC.

STATEMENT OF CASH FLOWS

	Year Ended September 30, 2006		Nine Months Ended September 30, 2005	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid during the period for:				
Interest expense	$	5,310	$	28,223
Income taxes	$	800	$	1,600
Non cash financing activities:				
Debt converted to capital	$	0	$	581,587

See notes to financial statements.

BUTTERFLY FITNESS, INC.

NOTES TO FINANCIAL STATEMENTS – SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005

Note 1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Nature of business:

Butterfly Fitness, Inc. (the Company) was incorporated on April 18, 2003, in California. The Company was formed to own and develop the franchise business for Butterfly Fitness Centers which offer fitness and weight loss programs to a core female customer base. Each center will offer fitness and nutritional programs, variable resistance strength equipment, and nutritional and weight loss supplements. The first franchise opened in February 2004.

The Company's management has filed a Franchise Offering Circular with the Commissioner of Corporations of the State of California and has been approved for franchising in every state of the U.S.

Basis of presentation:

The Company's balance sheet was prepared using accounting principles generally accepted in the United States of America.

Method of accounting:

The Company prepares its financial statements on the accrual method of accounting, recognizing income when earned and expenses when incurred.

Revenue recognition:

Initial franchise fees from the sale of Butterfly Fitness Centers franchises are recognized when all material services and conditions under terms of the franchise agreements have been performed or satisfied by the Company. Deferred revenue represents payments for franchise fees where all material services and conditions under the agreement have not yet been performed. Monthly franchise and advertising fees will be recognized as earned, net of an estimated allowance for uncollectible amounts.

Cash:

Cash includes cash and cash equivalents. The Company considers cash in banks and short-term investments with original maturities of three months or less to be cash. At September 30, 2006, the Company only held cash balances at a major bank.

Inventories:

The Company states its inventories at the lower of cost or market.

Property and equipment:

Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful life, normally five years. Leasehold improvements are amortized using the straight-line method over their estimated useful lives or the lease term, whichever is shorter. Maintenance and repairs are charged to expense. Major improvements are capitalized.

BUTTERFLY FITNESS, INC.

NOTES TO FINANCIAL STATEMENTS – SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005

Note 1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Video and other master production costs:

Costs of producing master videos and certain other costs such as website development are capitalized and amortized over the estimated useful lives of currently three years. These costs will be evaluated annually to determine that the costs are being recovered from expected future revenue of franchisor operations.

Advertising:

The Company capitalizes direct-response advertising production costs and expenses advertising communication costs the first time advertising takes place.

Deferred income taxes:

Deferred income tax assets and liabilities are computed annually for differences between the financial and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

Note 2. NATURE OF ESTIMATES:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make 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.

Note 3. CONCENTRATIONS OF CREDIT RISK:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of temporary cash investments and receivables from franchisees. Cash was held in one financial institution in amounts exceeding the guaranteed amount of the Federal Deposit Insurance Corporation. The Company performs ongoing credit evaluations of its franchisees' financial condition and generally, requires no collateral.

Note 4. RELATED PARTY TRANSACTIONS:

Butterfly Fitness, Inc. provided administrative operational support and office space to an affiliate during the year ended September 30, 2005. During that year, the Company received reimbursements in the amount of $49,886.

BUTTERFLY FITNESS, INC.

NOTES TO FINANCIAL STATEMENTS – SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005

Note 5. COMMITMENTS:

The Company has renewed an agreement to lease its office facility. This new lease is an amendment to the original agreement which expired September 30, 2005. Due to the increased business activity and work force, this new lease includes the occupancy of the entire facility.

Starting December 1, 2006, the Company is liable under a long-term lease of real property for the following minimum annual rentals:

Year Ending September 30,	
2007	$ 200,405
2008	262,964
2009	276,108
2010	289,916
2011	304,416
Total	$ 1,333,809

For the year ended September 30, 2006, rent expense totaled $184,047.

Note 6. CONTINGENCIES:

The Company has several asserted claims arising in the ordinary course of its business. While it is not feasible to predict or determine the outcome of the litigation or other asserted claims, it is the opinion of Company's management that the outcome will have no material adverse effect on the financial position of the Company and that no accrued liabilities for contingencies were necessary at September 30, 2006.

Note 7. INCOME TAXES:

The provision for income taxes shown in the accompanying statement of income (Exhibit B) comprises the following components:

	Year Ended September 30, 2006	Nine Months Ended September 30, 2005
Current	$ 800	$ 800
Deferred	32,000	(99,000)
Other adjustment	352	0
Net provision (recovery) for income taxes	$ 33,152	$ (98,200)

BUTTERFLY FITNESS, INC.

NOTES TO FINANCIAL STATEMENTS – SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005

Note 7. INCOME TAXES (Continued):

Deferred income taxes shown in the accompanying balance sheet (Exhibit A) comprise the following components:

	September 30, 2006	September 30, 2005	Net Change
Deferred tax assets	$ 67,000	$ 184,000	$ (117,000)
Valuation allowance on deferred tax assets	0	(85,000)	85,000
Net deferred income taxes	$ 67,000	$ 99,000	$ (32,000)
Net deferred income taxes are classified as:			
Current	$ 58,000	$ 88,000	$ (30,000)
Long-term	9,000	11,000	(2,000)
Totals	$ 67,000	$ 99,000	$ (32,000)

As of September 30, 2006, the Company had a net operating loss (NOL) carry forward of approximately $253,000 for Federal income taxes, expiring from 2023 to 2024, and $100,000 for California, expiring from 2013 to 2014, available to offset future taxable income.

The valuation allowance on the deferred tax asset has been eliminated. The Company anticipates generating additional revenues and will recognize income which will use the NOL carry forwards.

Note 8. SHAREHOLDERS' EQUITY:

Common stock:

The Company is authorized to issue 1,000,000 shares of common stock. In 2003, 121,200 shares of common stock were issued for $200,600 of cash proceeds to the Company. In 2004, the Company repurchased 7,200 shares for cost at $50,600.

Effective August 1, 2005 and pursuant to the second addendum to Shareholders' Agreement, the Company issued 12,000 shares for $200,000 in cash and the conversion of $455,246 in debt to common stock to an existing shareholder.

Of the $455,246 converted to capital, $54,246 was accrued interest. In addition, Company debt in the amount of $126,341 was converted to additional paid in capital with no issuance of additional shares. This debt was related to cash contributions made by shareholders in the amount of $93,000 and a line of credit which became the responsibility of the shareholders personally. As of September 30, 2005, the total amount of debt contributed to capital amounted to $581,587.

BUTTERFLY FITNESS, INC.

NOTES TO FINANCIAL STATEMENTS – SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005

Note 9. **JAPAN FRANCHISING:**

As of December 5, 2005, the Company has sold to a Japanese corporation the franchise rights for Japan.

Note 10. **PROFIT-SHARING AND DEFINED BENEFIT PLAN:**

Effective October 1, 2005, for the exclusive benefit of all eligible Employees and their beneficiaries, the Company established the Butterfly Fitness, Inc. Profit Sharing Plan. This Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). For the year ended September 30, 2006, the Company contributed $24,391 to the Profit Sharing Plan.

On the same date, the Company adopted the Butterfly Fitness, Inc. Defined Benefit Pension Plan. This Plan covers all eligible employees and their beneficiaries. As in the profit sharing plan, eligibility is attained at age 21 and after completing one year of service. Each year, the employer is required to contribute an actuarially determined amount to the Plan to fund the benefits provided under the Plan. The amount of the contribution varies from year to year depending on such factors as the Plan's participant turnover, benefit payments, and the trust's investment gain and losses. The Employer is subject to penalties if it does not meet certain minimum funding standards set forth by law. For the year ended September 30, 2006, the Company contributed $195,000 to the Defined Benefit Pension Plan.

BUTTERFLY FITNESS, INC.

Financial Statements

For the year ended December 31, 2004

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SWEENEY ◆ KOVAR, LLP
Accountants and Advisors

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders
Butterfly Fitness, Inc.
San Ramon, California

We have audited the accompanying balance sheet of Butterfly Fitness, Inc. (the Company) as of December 31, 2004, and the related statements of operations, cash flows and shareholders' equity (deficit) for the year ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Butterfly Fitness, Inc. as of December 31, 2004, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Sweeney Kovar, LLP

Danville, California
March 25, 2005

3800 Blackhawk Road, Suite 100 ◇ Danville, CA 94506 ◇ (925) 648-3660 ◇ (925) 736-4382 FAX ◇ www.cpask.com

BUTTERFLY FITNESS, INC.

Balance Sheet
December 31, 2004

Assets

Current Assets	
Cash	$ 17,046
Accounts receivable	12,488
Inventory	10,905
Prepaid expenses	27,545
	67,984
Property and equipment	
Furniture and equipment	28,683
Accumulated depreciation	(2,116)
	26,567
Other assets	
Video and other master production costs	169,493
Accumulated amortization	(14,124)
	155,369
	$ 249,920

Liabilities and Shareholders' Equity (Deficit)

Current Liabilities	
Accounts payable	$ 43,718
Payroll and payroll taxes payable	28,699
Accrued expenses and other liabilites	50,951
Interest payable to shareholders	31,137
Payable to shareholders	45,000
Note payable to shareholder	386,000
Deferred revenue - franchise fees	142,000
	727,505
Shareholders' Equity (Deficit)	
Common stock, no par value, 1,000,000 shares authorized; 114,000 issued and outstanding	150,000
Accumulated deficit	(627,585)
	(477,585)
	$ 249,920

See notes to financial statements.

BUTTERFLY FITNESS, INC.

Statement of Operations

For the year ended December 31, 2004

Franchise fees and revenues	
Initial franchise fees	$ 743,000
Monthly royalty fees	90,000
Other revenues	17,759
	850,759
Operating Expenses	
Cost of franchise equipment	210,094
Salaries and payroll taxes	376,800
Legal and professional fees	134,663
Advertising	95,541
Administrative charges by affiliate	48,961
Other operating expenses	134,094
	1,000,153
Loss From Operations	(149,394)
Other Income (Expense)	
Interest expense	(33,108)
Gain on sale of furniture and equipment	2,285
Franchise tax	(800)
	(31,623)
Net Loss	$ (181,017)

See notes to financial statements.

BUTTERFLY FITNESS, INC.

Statement of Cash Flows

For the year ended December 31, 2004

Cash Flows From Operating Activities	
Net loss	$ (181,017)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:	
Depreciation and amortization	17,432
Changes in Operating Assets and Liabilities:	
Accounts receivable	(12,488)
Inventory	(10,905)
Prepaid expenses	(27,415)
Accounts payable	(47,365)
Payroll and payroll taxes payable	16,602
Accrued expenses and other liabilites	50,951
Interest payable to shareholders	31,137
Deferred revenue - franchise fees	99,500
Due to affiliate	(20,835)
	(84,403)
Cash Flows From Investing Activities	
Video and other master production costs	(169,493)
Purchase of furniture and equipment	(28,743)
Proceeds on sale of furniture and equipment	11,549
	(186,687)
Cash Flows From Financing Activities	
Proceeds from note payable to shareholder	324,368
Repurchase shares of common stock	(50,600)
	273,768
Net Increase in Cash	2,678
Cash, beginning of year	14,368
Cash, end of year	$ 17,046

See notes to financial statements.

BUTTERFLY FITNESS, INC.

Statement of Shareholders' Equity (Deficit)
For the year ended December 31, 2004

	Common Stock		Accumulated	
	Shares Issued	Amount	Deficit	Total
Balances at December 31, 2003	121,200	$ 200,600	$ (446,568)	$ (245,968)
Repurchase of shares	(7,200)	(50,600)	-	(50,600)
Net loss - 2004	-	-	(181,017)	(181,017)
Balances at December 31, 2004	114,000	$ 150,000	$ (627,585)	$ (477,585)

See notes to financial statements.

BUTTERFLY FITNESS, INC.

Notes to Financial Statements

For the year ended December 31, 2004

1. **General and Summary of Significant Accounting Policies**

General

Butterfly Fitness, Inc. (the Company) was incorporated on April 18, 2003, in California. The Company was formed to own and develop the franchise business for Butterfly Fitness Centers which offer fitness and weight loss programming to a core female customer base. Each center will offer fitness and nutritional programming, variable resistance strength equipment, and nutritional and weight loss supplements. The first franchise opened in February 2004.

Basis of Presentation

The Company's balance sheet was prepared using United States generally accepted accounting principles applicable to a going concern, which assumes the realization of assets and payment of liabilities in the normal course of business. The Company's management has filed a Franchise Offering Circular with the Commissioner of Corporations of the State of California and also has filed in several other states. The Company's ability to continue as a going concern is dependent on selling franchises, obtaining additional funding and operating profitably, which the Company is planning to accomplish during 2005. Since December 31, 2004, the Company has sold four additional franchises and it is currently pursuing additional equity funding in connection with a restructuring of Company debt.

Method of Accounting

The Company prepares its financial statements on the accrual method of accounting, recognizing income when earned and expenses when incurred.

Revenue Recognition

Initial franchise fees from the sale of Butterfly Fitness Centers franchises are recognized when all material services and conditions under terms of the franchise agreements have been performed or satisfied by the Company. Monthly franchise and advertising fees will be recognized as earned, net of an estimated allowance for uncollectible amounts. The initial franchise fees received for single franchises consist of $29,500 ($10,000 for initial training, $10,000 for fitness equipment and the remaining $9,500 due thirty days prior to opening the franchise club). Initial franchise fee revenues are recognized upon completion of initial training, then upon the delivery of pre-opening equipment to the franchisee and the remaining amount is recognized generally after the opening of a club, since the Company is responsible for various pre-opening assistance and training prior to the opening of each club. At December 31, 2004, $142,000 has been recorded as deferred revenue, pending completion services under the franchise agreements.

BUTTERFLY FITNESS, INC.

Notes to Financial Statements
(continued)
For the year ended December 31, 2004

1. **General and Summary of Significant Accounting Policies (continued)**

Revenue Recognition (continued)
As of December 31, 2004 and since inception of the Company in April 2003, the Company's franchise activity was as follows:

Franchises sold	59 (a)
Franchises opened	14
Franchises sold, not opened yet	28
Franchises defaulted, did not open	17
Franchises closed	0
	59

(a) In 2003, the Company sold 2 franchises and had received $42,500 in initial franchise fees which was recorded as deferred revenue at December 31, 2003 and recognized as revenue in 2004.

Cash
Cash includes cash and cash equivalents. The Company considers cash in banks and short-term investments with original maturities of three months or less to be cash. At December 31, 2004, the Company only held cash balances at a major bank.

Property and Equipment
Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful life, normally five years. Leasehold improvements are amortized using the straight-line method over their estimated useful lives or the lease term, whichever is shorter. Maintenance and repairs are charged to expense. Major improvements are capitalized.

Video and Other Master Production Costs
Costs of producing master videos and certain other costs (principally web site development) are capitalized and amortized over the estimated useful lives of currently three years. These costs will be evaluated annually to determine that the costs are being recovered from expected future revenue of franchisor operations.

Advertising
The Company capitalizes direct-response advertising production costs and expenses advertising communication costs the first time the advertising takes place. The Company had $15,101 in capitalized advertising costs at December 31, 2004 and $95,541 of advertising expenses incurred in 2004.

BUTTERFLY FITNESS, INC.

Notes to Financial Statements

(continued)
For the year ended December 31, 2004

1. **General and Summary of Significant Accounting Policies (continued)**

Use of Estimates
The preparation of financial statements in conformity with United States generally accepted accounting principles requires management to make 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.

Income Taxes
The Company accounts for income taxes under the liability method, which recognizes deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the book and tax bases of assets and liabilities, and for net operating loss and tax credit carryforwards. A valuation allowance is established for any deferred tax assets for which realization is uncertain. At December 31, 2004, the Company had a net operating loss (NOL) carryforward of $637,000 for Federal income taxes, expiring from 2023 to 2024, and $619,000 for California, expiring from 2013 to 2014, available to offset future taxable income. The tax benefit of the NOL carryforwards amounts to a deferred tax asset of $227,000 which is fully offset by a valuation allowance at December 31, 2004. Accordingly, no income tax assets, liabilities or expenses are recorded in the accompanying financial statements for the year ended December 31, 2004, except for the $800 California annual minimum franchise tax expense.

Concentrations of Credit Risk
Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of temporary cash investments and receivables from franchisees. The Company maintains its cash balances in one financial institution located in Walnut Creek, California with balances insured by the FDIC up to $100,000. The Company performs ongoing credit evaluations of its franchisees' financial condition and generally, requires no collateral. As of December 31, 2004, the Company had no significant concentrations of credit risk.

BUTTERFLY FITNESS, INC.

Notes to Financial Statements

(continued)
For the year ended December 31, 2004

2. **Related Party Transactions**

Related party transactions consisted of the following:

The principal founding shareholders of the Company are also the controlling shareholders of the fitness center business, Women's Workout and Weight-Loss Centers, Inc. ("WWW"), which sold all its remaining clubs in December, 2004.

At December 31, 2004, the Company had a note payable to a shareholder for $386,000 and $31,137 of accrued interest at 9% which were payable by December 31, 2004, and currently are payable on demand.

At December 31, 2004, the Company had $45,000 payable to shareholders from cash advances which bears interest at 5.75% and is payable on demand.

WWW has provided administrative operational support and office space to the Company which totaled $48,961 in 2004. The Company purchased furniture and equipment from WWW in 2004 for $24,528 at WWW's net book value. At December 31, 2004, the Company had no amounts due to WWW.

In January 2005, the Company's shareholders advanced $73,000 of cash to the Company.

See other footnotes which also include related party transactions, including Note 3 covering lease obligations.

3. **Lease Obligations**

As of February 2005, the Company assumed the corporate office rent obligation of WWW. The obligation under the lease, which expires in November 2005, totals $151,417 (gross obligation of $201,417 less $45,000 of cash received from WWW in January 2005). Presently, the Company is negotiating with the landlord to renew the lease at a lower rent rate and is currently paying $7,347 per month to the landlord.

BUTTERFLY FITNESS, INC.

Notes to Financial Statements

(continued)
For the year ended December 31, 2004

4. **Contingencies**

The Company is a defendant in litigation involving a contract to assist in the preparation of fitness videos and other services in exchange for a percentage of video sales. The Company also has several asserted claims arising in the ordinary course of its business. While it is not feasible to predict or determine the outcome of the litigation or other asserted claims, it is the opinion of Company's management that the outcome will have no material adverse effect on the financial position of the Company and that no accrued liabilities for contingencies were necessary at December 31, 2004.

5. **Shareholders' Equity**

Common Stock
The Company is authorized to issue 1,000,000 shares of common stock. In 2003, 121,200 shares of common stock were issued for $200,600 of cash proceeds to the Company. The common stock issued by the Company pursuant a Shareholders' Agreement, effective May 27, 2003, as amended June 2, 2003, provides for the repurchase of shares first at the option of the Company, second at the option of all other shareholders on a pro-rata basis, and third intended transferee(s) of the transferring shareholder. Under certain terms, the value of shares would be based on one times the Company's gross operating revenues, as defined. Certain of the shares were issued to the Company's prior president pursuant to an employment agreement, which provides for the repurchase of shares at cost (7,200 shares for $50,600) if employment terminated prior to April 30, 2004. Since termination occurred in March 2004, the Company repurchased the 7,200 shares for $50,600. At December 31, 2004, the Company had 114,000 shares of common stock issued.