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

FORM 10-K

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

For the fiscal year ended December 31, 2006

Commission file number 000-32421

FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.
(Exact name of registrant as specified in charter)

Delaware	58-2342021
(State or other jurisdiction of incorporation or organization)	(IRS employer identification no.)

420 Lexington Avenue, Suite 1718
New York, New York 10170
(Address of principal executive offices) (Zip code)
(212) 201-2400
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	**American Stock Exchange**
Redeemable Common Stock Purchase Warrants	**American Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ☐ No ☒

Indicate by a check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, accelerated filer, or non-accelerated filer. See Definition of "accelerated filer and large accelerated filer" as defined in Rule 12b-2 of the Exchange Act.
Large Accelerated Filer ☐ Accelerated Filer ☐ Non-Accelerated Filer ☒

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

The aggregate market value of the voting Common Stock held by non-affiliates of the Registrant based upon the closing price of the common stock as reported by the American Stock Exchange on March 26, 2007, was $12,703,670. Solely for purposes of this calculation, shares beneficially owned by directors and officers of the Registrant and persons owning 5% or more of the Registrant's common stock have been excluded, in that such persons may be deemed to be affiliates of the Registrant. Such exclusion should not be deemed a determination or admission by the Registrant that such individuals or entities are, in fact, affiliates of the Registrant.

The number of shares outstanding of the Registrant's capital stock as of March 26, 2007, is as follows:

Title of Each Class	Number of Shares Outstanding
Common Stock, $0.01 par value	**26,971,465**
Redeemable Common Stock Purchase Warrants	**7,641,838**

DOCUMENTS INCORPORATED BY REFERENCE

The following documents (or parts thereof) are incorporated by reference into the following parts of this Form 10-K. Certain information required in Part III of this Annual Report on Form 10-K is incorporated from the Registrant's Proxy Statement for the 2007 Annual Meeting of Stockholders to be held in 2007

2006 FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.
ANNUAL REPORT ON FORM 10-K

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PART 1

Item 1. Business

Overview

Fusion Telecommunications International, Inc. (the terms "Company", "us", and/or "we" and other similar terms as used herein refer collectively to the Company together with its principal operating subsidiaries) provides Voice over Internet Protocol telecommunications services (VoIP) to, from, in and between emerging markets in Asia, the Middle East, Africa, the Caribbean, and Latin America. We currently market VoIP services to consumers, corporations, Internet service providers, distribution partners and telecommunications carriers.

Through our key assets of market knowledge, technical expertise and strategic relationships, we believe we are poised to:

- Capitalize upon the growth in VoIP telecommunications, a market that Insight Research Corporation expects to grow from $82 billion in 2005 to nearly $197 billion by 2007 and expand our international penetration of VoIP applications to consumers and corporations;

- Deliver customized VoIP services designed to meet the needs of the emerging markets and communities of interest worldwide;

- Deliver a complete suite of VoIP service offerings for corporations and consumers;

- Establish our company as a global telecommunications service provider;

- Continue to expand the number of partnerships globally to facilitate the distribution of our VoIP services; and

- Bridge the migration from traditional telephony to VoIP through the introduction of the Worldwide Internet Area Code.

We target markets that we believe have: (i) barriers to entry, (ii) substantial growth prospects, (iii) an increasing number of corporations operating within them, (iv) high cost of telecommunications services, and (v) a substantial quantity of voice and data traffic between the developed world (e.g., the United States and United Kingdom) and other countries within our target markets. In select emerging markets, we will deploy network facilities in order to connect that country to the United States.

We currently provide services to customers in over 100 countries. We believe that by using local partners in select markets, we can best distribute our services while providing a high level of local customer support.

Services

To date, we derive a significant portion of our revenues primarily from U.S.-based carriers requiring VoIP connectivity to emerging markets. As we continue to execute our strategy, we anticipate a larger number of non-U.S. based customers. We are currently seeking to expand our retail VoIP revenue stream to consumers and corporations by providing our services to, from, in and between emerging markets, which to date, have not generated material revenues for us. We deliver our VoIP services directly to end-users and through partnerships with companies that distribute and support our services locally. We also deliver our services through joint ventures.

We have service contracts with our customers, including carriers, corporations and consumers. Our contracts with carriers typically have a one-year renewable term, with no minimum volume per month, and allow the customer to terminate without penalty. Our contracts with corporate customers are typically for a one-year term, and have an early cancellation penalty. For the years ended December 31, 2006, 2005, and 2004, the Telco Group accounted for 16.2%, 11.3%, and 13.3%, respectively, of our total revenues. In addition, for the years ended December 31, 2006 and 2005, Qwest accounted for 23.2% and 15.7% of our total revenues, respectively.

Our voice services to carriers accounted for the majority of our revenues in 2006 and 2005. Our retail VoIP service enables customers, typically for a lower cost than traditional telephony, to place voice calls anywhere in the world using their personal computers, Internet protocol phones or regular telephones when accompanied by a hardware device. VoIP services utilize the Internet as opposed to circuit switching (traditional telephony technology), thereby offering cost savings to customers. These services are primarily offered under our retail brand Efonica directly to consumers, corporations, distribution partners, or Internet Service Providers around the world. In select cases, we will also provide co-branded and private label solutions. Our services are offered to customers located in Asia, the Middle East, Africa, and Latin America.

Additionally, we enter into interconnection agreements with telecommunications carriers worldwide. These agreements enable us to terminate traffic into a country and in some cases receive traffic from that country. We use the capacity obtained through these interconnection agreements to carry our own retail traffic in addition to selling capacity to other carriers desiring voice termination to those destinations. As we grow, we expect to use an increasing percentage of our capacity for higher margin retail traffic. We offer facility co-location services to other communication service providers, enabling them to co-locate their equipment within our facility, or lease a portion of our equipment. Often, we provide wholesale services to the parties who co-locate with us.

In the second quarter of 2007, we will begin marketing Corporate Retail Services within the United States. We will offer hosted IP-PBX services for those companies wishing to outsource the management of their telecommunications facilities. We will also offer IP trunking solutions for companies wishing to retain their existing telecommunications infrastructures, but still reap the benefits of VoIP telephony. We will also offer our corporate customers Internet access, toll free services, conference calling, and a premium version of our Mobilink service. On a selective basis, we will offer corporate customers certain advanced solutions, including virtual private networks, private line services, and managed network services.

Our segments and their principal activities consist of the following:

Voice Services to Carriers - Voice services to carriers includes VoIP to carriers, which is the termination of voice telephony minutes by the Internet rather than older circuit-switched technology. VoIP permits a less costly and more rapid interconnection between our network and international telecommunications carriers. This segment also includes Traditional Voice (the termination of voice telephony minutes from or to the countries we serve, utilizing traditional Time Division Multiplexing (TDM) or “circuit-switched” technology. Typically, this will include interconnection with traditional telecommunications carriers either located internationally or those carriers that interconnect with us at their U.S. Points of Presence (POP) and provide service to other destinations. These minutes are sold to carriers on a wholesale basis.

Consumers, Corporations and Other - We provide VoIP services targeted to consumers and corporations. We offer services that permit our customers to originate calls via IP telephones or telephone systems and use the Internet to complete those calls to standard telephone lines anywhere in the world. We also provide PC-to-Phone services that allow consumers to use their personal computers to place calls to the telephone of the called party. For corporate customers, we offer fully hosted IP-PBX services, as well as IP trunking solutions and Internet access. In addition, we selectively offer point-to-point private lines, virtual private networking, and call center services to certain customers within our target markets.

Growth Strategy

Strategy: Our strategy is to provide a full suite of VoIP services to consumers and corporations in the emerging markets and to the international communities of interest around the world. We look to create local partnerships to facilitate distribution of our services within our target countries. We also look to create global partnerships to facilitate global distribution of our services.

The details of our strategy include:

- **Market Customized VoIP Calling Plans to Consumers and Corporations**

Our key service offering is VoIP, which allows us to offer feature-rich, prepaid and monthly subscription Internet-based telephone services at competitive prices to any consumer or business with broadband or dial-up Internet access. Quality levels, which had once been a significant issue, are fast approaching those associated with traditional voice transmission. We typically market our VoIP services to corporations and consumers through an in-country distribution partner. Many of our target markets have different cultures, calling patterns, and payment options requirements. Our marketing strategy focuses on delivering customized VoIP calling plans, feature packages and payment option to meet the needs of the target market and communities of interest around the world. We intend to build upon our market position in the international VoIP business to selectively market our VoIP services to the enterprise market. We believe that the ability to deliver global Internet access and managed private networks and other Internet-based services to multinational businesses are important capabilities in allowing us to address this market segment.

- **Establish Local Partners for In-Country Distribution and Support**

We believe that working with strong partners allows us to best distribute services and attract, retain and support customers. We seek to develop partnership arrangements in each of our markets. Local partners offer advantages since their existing infrastructure, sales distribution channels, and technical support can be utilized, while simultaneously reducing capital needed to enter the market. We seek to partner with companies that have access to a customer base, whether online or otherwise, such as Internet service providers, wireless Internet access providers, licensed carriers, online retailers, electronics outlets, and hardware manufacturers. We intend to work with our partners to enable them to distribute and support our products and services. In select cases, we offer a co-branded or private label option. Our private label alternative enables our partners to market our products, technology platform and global reach under their own brand. This alternative is ideal for partners that do not have the capital, expertise and technology platform required to deliver our services but want to build their own brand. Local partners also offer critical insights into the regulatory environment and are familiar with the specific cultural nuances of their region. Additionally, we anticipate that prior to the rollout of any new services, our partners will work with us in contributing market intelligence to ensure a successful introduction of new products.

- **Deploy a Carrier Grade Network Infrastructure**

We have built a highly scalable network and back office infrastructure to deliver our services. We utilize the latest Softswitch technology for routing VoIP and TDM calls to off-net customers.

We are developing and deploying back-office systems and service platforms that will enable us to offer our customers a wide array of services and features, including comprehensive feature packages, pre-paid subscription-based calling plans, and free on-net calling. The development of this extensive scalable back office will also serve to reduce our dependence on other communication carriers. We believe our focus on being a carrier grade VoIP service provider enables us to deliver the quality of service required by our customers.

- **Develop International Interconnections to Carriers**

We seek to enter into relationships with in-country carriers to transport voice traffic to and/or from that country. We believe that we have established our presence in the voice markets due to (i) direct interconnections to postal telephone and telegraph companies and other licensed carriers, which typically provide higher quality transmission than the services offered by “gray market” operators, and (ii) competitive pricing. We believe that carriers seeking to access these markets will increasingly want to work with companies that have established relationships with postal telephone and telegraph companies and other licensed carriers, as opposed to quasi-legal operators who divert long distance traffic and revenue from those carriers. We believe gray market operators generally provide poorer quality and reliability. In several markets, we receive inbound traffic from the postal telephone and telegraph company and other licensed carriers that tend to produce higher margins than our outbound carrier voice services. We believe this inbound traffic from postal telephone and telegraph companies and other licensed carriers, strengthens our ability to ensure favorable contractual arrangements. We will use capacity on our international voice networks to carry our own retail traffic in addition to selling capacity to other carriers desiring termination to those specific destinations. Although there are significant peaks and valleys in the carrier revenue stream, we believe it is important to our success in the retail market to keep our cost basis low and our quality high. As we progress in the execution of our business plan, we intend to use a greater percentage of our network capacity to carry higher margin retail traffic.

- **Exploit Communication Patterns Among and Between our Markets**

We look to provide connectivity to, from, in and between our emerging markets. We seek to create international interconnections with global carriers to carry our international traffic. We are targeting customers in synergistic markets to leverage the communities of interest by providing customized calling and feature service plans designed to meet the needs of ethnic communities around the world. Our regional marketing plan is focused on the emerging market communities of interest around the world. We are also seeing demand from business customers for multi-country connectivity such as a U.S. corporation seeking connectivity to India, China, and the Philippines from one provider. We also believe that traffic among emerging markets is less susceptible to price and margin erosion than traffic among developed countries.

Marketing

Our VoIP marketing strategy focuses on delivering customized calling plans, feature packages and payment options to meet the needs of emerging markets and ethnic communities around the world. Our VoIP service works with a broadband or a dial-up connection to the Internet; a capability that we believe has been ignored by many VoIP service providers. We believe this service delivery flexibility is very important, since approximately 70% of the world's Internet users still connect through dial-up.

We market VoIP services to consumers, corporations, Internet Service Providers and carriers through direct sales or distribution partners. Internet access and private network solutions are marketed through direct and alternate distribution channels.

We market our services via a variety of distribution channels, including:

- ***Direct Sales and Regional Management*** - We have a direct sales force that sells our products and services to corporations and carriers. We also have regional sales management that focuses on Latin America, Asia, Africa, the Middle East and the Caribbean. The regional executives manage and grow existing revenue streams from partners and defined strategic accounts, identify and develop new partnerships, develop strategies for market penetration, identify new market opportunities, and coordinate internal support activities.

- ***Agents*** - We use independent sales agents to sell our services. Our sales agents are compensated on a commission-based structure. We typically control the product, pricing, branding, technical and secondary level customer support, billing and collections.

- ***Partnerships*** - We seek to develop partnership arrangements in each of our markets with companies that are able to distribute and support our services. These partners can be ISPs, retail store chains, carriers, cable operators and other distribution companies. In addition to local distribution and support, our partners may provide or arrange for last mile connectivity required for the delivery of local Internet access and private networks. We also focus on the development of global partnerships that have multi-country distribution capabilities.

- ***Strategic Ventures*** - We enter into agreements with other companies to market and distribute each other's products and services to the customer and prospect base of the other. The providing party usually will support and bill its own products. Depending on the strategic venture, we may pay or receive a commission or share revenue and/or profits with each other.

Efonica

Efonica was incorporated in the Technology, Electronic Commerce and Media Free Zone in Dubai, United Arab Emirates and entered into a joint venture agreement with us in 2002.

In January 2005, we entered into an agreement to acquire the remaining 49.8% minority interest in Efonica from Karamco, Inc., which was contingent upon the successful completion of our initial public offering by March 1, 2005. As our IPO was completed by this date, the Efonica transaction closed on February 18, 2005. The purchase price was $9,785,700 representing Karamco's portion of Efonica's debt owed to us as of the closing date and the $500,000, which was paid in cash in February 2005 to Karamco with the balance paid in shares of common stock. The number of shares issued to Karamco was determined by the $6.45 per share initial price of the common stock at the date of the IPO.

Approximately $4.4 million worth of such common stock (675,581 shares) issued to Karamco was being held in escrow (the "Escrow Shares"). In March 2006, the Escrow Shares were released to Karamco subject to a lock-up period until February 15, 2007.

Out of the shares issued to Karamco, we registered for resale 150,000 shares of common stock and a registration statement covering such shares was declared effective on June 21, 2005 (the "Registered Shares"). If the sale of the 150,000 shares that were registered results in less than $1 million of gross proceeds within 635 days of the effectiveness of the registration statement, we are required to pay Karamco the difference between the aggregate gross proceeds of Karamco's sale of the Registered Shares and $1,000,000. At December 31, 2006, the Company has paid Karamco $430,000 towards the difference payment ("Difference Payment"). In the event the Difference Payment is less than $430,000, Karamco is obligated to reimburse for such excess and this obligation is secured by 50,387 shares held in escrow.

Roger Karam, who became our President of VoIP Services upon the effective date of the IPO, owns Karamco.

Efonica F-Z, LLC is presently integrated with the rest of our organization and Efonica is presently serving as our consumer services brand.

Joint Ventures

We enter into formal joint venture agreements with certain partners and have established four joint ventures to market and provide our services. The profits of each joint venture agreement are typically allocated according to percentage of equity ownership.

The terms of each non-joint venture partnership or distribution agreement are different by partner but in general provide for a revenue or profit sharing arrangement.

India

In March 2000, we entered into a joint venture agreement with Communications Ventures India Pvt. Ltd. to form an entity named Estel Communication Pvt. Ltd. Estel is organized and existing under the laws of India and has its office in New Delhi, India. We own 49% of the joint venture and have voting rights in another 1.01%, which in turn gives us an indirect 50.01% voting control in the joint venture. Estel is in the business of selling and supporting VoIP, private networks and Internet access in India. Primarily we have funded the joint venture. Our joint venture partner has had a lack of resources necessary to make investments to grow our operations or fund its commitments to us. As of December 31, 2006 and 2005, the amounts due from Estel were approximately $431,000 and $29,000, which is net of an allowance of approximately $414,000 and $834,000, respectively.

Jamaica

In January 2005, we concluded an agreement to acquire 51% of the common stock of a Jamaican telecommunications company in exchange for $150,000. The company currently holds international and domestic carrier license agreements with the Jamaican government, which enable it to operate as an international carrier through 2013 and as a domestic carrier through 2018.

In October 2006, we executed an agreement accepting an offer from a third party to purchase certain assets and liabilities of our holdings in Jamaica. The contract associated with that offer was subsequently defaulted on, and the Company is vigorously pursuing legal action associated with this default. Although the Company intends to do business in Jamaica in the future, we have reviewed the assets associated with that subsidiary, and as a result of the changes in the Company's business plan, we have impaired approximately $277,000 associated with the assets of this entity during the year ended December 31, 2006.

Turkey

On March 8, 2005, through a wholly owned subsidiary, Fusion Turkey, LLC, we entered into a Stock Purchase Agreement to acquire 75% of the shares of LDTS Uzak Mesafe Telekomikasyon ve Iletisim Hizmetleri San.Tic.A.S. ("LDTS") from the existing shareholders. The transaction closed on May 6, 2005 following receipt of approval from the Turkish Telecom Authority. Fusion acquired the shares for approximately $131,000 cash and the posting of a bank guarantee of $251,000. LDTS possesses a Type 2 telecommunications license approved by the Turkish Telecom Authority. This license permitted Fusion to offer VoIP services under its Efonica brand and other Internet services to corporations and consumers in Turkey.

During the year ended December 31, 2006, we decided to begin winding up and liquidating our Turkey joint venture. This decision was a result of various challenges we encountered from an increasingly complicated and constantly changing regulatory environment in Turkey, which made it very difficult to enter the market. These regulatory difficulties included an unstable environment as well as the selling of Turk-Telecom, which was a government owned entity, to a private company. As a result of this decision, the operations of this subsidiary are being treated as a discontinued operation.

Network Strategy

Our network strategy incorporates a packet switched platform capable of interfacing with Internet protocols and other platforms including Time Division Multiplexing (“TDM”). This is key to providing the flexibility needed to accommodate the many protocols used to transport voice and data today. We continually evaluate, and where appropriate, deploy additional communications technologies such as Multi-Protocol Label Switching (“MPLS”) and Any Transport over MPLS (“ATOM”), which handle information transport in a more efficient fashion than other earlier technologies such as frame relay and ATM.

The core of our network design is a packet-based switching system that accommodates VoIP and traditional voice, Internet, data and video services. Packet-based networking is considerably more efficient than circuit-switched systems because it can disperse packets (information) in many directions and then reassemble them at the destination. This makes much more efficient use of available facilities when compared to circuit-based systems. We believe that this design offers an extensible platform to support envisioned growth. The network design is intended to embrace emerging technologies as they become available. The network architecture is highly distributable and supports geographical expansion outside of the United States and, if necessary, can deliver packet technology to every part of the network.

We are currently using a Veraz “Softswitch”, Cisco and Nuera Orca media gateways, and carrier class Cisco routers and switches on a fiber-based gigabit Ethernet backbone to transport voice and data traffic. Softswitch is a generic term that refers to a new generation of telecommunications switching equipment that is entirely computerized and based on software processes that execute entirely on off-the-shelf servers. This provides us with call control and routing capabilities to further enhance service and performance available to our clients.

We have deployed back-office systems and services platforms that will enable us to offer our customers a wide-array of VoIP services and features, including subscription-based calling plans, free on-net calling, advanced feature packages, conferencing, and unified messaging. This development of an extensive scalable back-office will also serve to reduce our dependence on other communication carriers.

Benefits of the Fusion Distributed Network Architecture

Historically, most large international communications networks required investment and implementation of self-contained switching hardware that, in turn, could then be connected with other comparable equipment nodes via leased lines or other forms of networking. Examples of these would include equipment such as large traditional carrier switching equipment. All of the intelligence and functionality had to be replicated in each major location.

We, however, have implemented an environment that we believe is far more flexible, adaptable, and less costly than the legacy systems in use by some of our competition. Our Softswitch environment permits us to centrally control our network and service offerings from one location yet deploy gateways that interface with customers and vendors in remote locations. Each remote gateway is able to deliver our service suite even though the intelligence is centrally located in our New York facility. Instead of needing duplicative and expensive infrastructure in every location, we economize by allowing multiple disparate network equipment to be centrally managed. We believe that we can capitalize on market opportunities that would previously have been unadvisable due to the expense of deployment and associated marketplace risks.

Capacity

In traditional telecommunications systems, capacity is a function of equipment and software. Because of its modular architecture, Softswitch capacity is much less dependent on hardware. We believe that our Softswitch environment will enable us to expand our capacity to handle traffic and our geographic reach with greater ease in the future.

Ease of Modular Service Creation

Traditional telecommunications switching systems are not easily modified to incorporate new features and functionality. Because our Softswitch environment is entirely computer driven, our systems are flexible and designed for the addition of features. We intend to expand our service offerings by integrating additional hardware and software systems.

Our distributed architecture and flexible technology platform allows us to roll out new services in a shorter period of time than many traditional telecommunication companies.

Ease of Deployment

As we continue to penetrate emerging retail markets, or as we establish interconnect agreements with additional foreign carriers, we will seek to establish regional points of presence that are connected back to our New York switching center. These regional points of presence will enable our VoIP services to be offered and delivered from remote locations, while the network intelligence and management of the services reside in our New York facility. This modular approach will also allow us to quickly respond to new market opportunities and deploy our new services rapidly.

Competition

The international telecommunications industry is highly competitive and significantly affected by regulatory changes, technology evolution, marketing strategies, and pricing decisions of the larger industry participants. In addition, companies offering Internet, data and communications services are, in some circumstances, consolidating. We believe that service providers compete on the basis of price, customer service, product quality, brand recognition and breadth of services offered. Additionally, carriers may compete on the basis of technology. Recently, we have seen carriers competing on their ability to carry VoIP. As technology evolves and legacy systems become an encumbrance, we expect carriers to compete on the basis of technological agility, their ability to adapt to, and adopt, new technologies.

In the area of VoIP we compete with companies such as Vonage, 8X8, Deltathree, Net2Phone, Skype and Mediaring. This business segment is marketing-intensive and does not have high barriers to entry. While we believe our distribution relationships and marketing skills provide us with a competitive advantage, our competitors generally have more resources and more widely recognized brand names.

We compete with several emerging international carriers, many of whom are in or entering the VoIP market, among which are Primus Telecommunications Group, VSNL, and IDT Corporation. We also compete with non-U.S. based emerging carriers. For example, in India, we compete with Bharti Tele-Ventures, Reliance Telecom and Data Access, all of which are larger, better capitalized and have broader name recognition than Fusion. Many of these competitors are becoming increasingly focused on emerging markets, as they seek to find higher margin opportunities. Many of these carriers are also focused on voice carriage, but may become increasingly focused on providing private networks and other Internet protocol services.

We also compete within the “Free Service” segment of the VoIP market, which is also a rapidly growing market segment. The current market leader in this segment is Skype. Other major players moving into this segment include Yahoo, Google, and MSN. Each of these companies offers an instant messenger (IM) service that incorporates the ability to make free computer-to-computer voice calls between registered users. By comparison, we are targeting individuals who are more focused on telephony applications than enhanced IM applications, and will offer the ability to make calls between any combination of computer, IP phones, and analog phones connected to an ATA device. In fact, there is no need to have a computer turned on, or even own a computer, to use our free service. We believe that this service will not only generate significant interest among users, but that it will also generate customers interested in upgrading to enhanced capabilities (e.g. voice mail or off-net calling) or to our subscription service offerings.

In each country where we operate, there are numerous competitors, including VoIP service providers, wireline, wireless and cable competitors. We believe that as international telecommunications markets continue to deregulate, competition in these markets will increase, similar to the competitive environment that has developed in the United States following the AT&T divestiture in 1984 and the Telecommunications Act of 1996. Prices for long distance voice calls in the markets in which we compete have been declining and are likely to continue to decrease. In addition, many of our competitors are significantly larger, control larger networks, and have substantially greater financial, technical and marketing resources.

We compete with business-oriented Internet access providers, including AT&T, Verizon, Qwest, and Cable & Wireless. These providers may offer both wholesale and retail Internet connectivity and are considerably larger than us and have greater brand recognition.

We have been unable to identify any direct and comprehensive competitors that deliver the same suite of services to the same markets with the same marketing strategy as we do. We compete with many different providers in various aspects of our Business Plan, but have found none that directly offer the same breadth of services focused on emerging markets. Some of our competitive advantages include:

- A full suite of services that complement our VoIP service offerings as opposed to a single offering;
- The ability to offer prepaid, monthly recurring service plans and free service to customers using broadband or dial-up Internet access;
- Connectivity with over 150 carriers worldwide;
- Worldwide Internet Area Code;
- A bundled product offering VoIP service and Internet access to corporate users;
- Our focus on emerging markets in Latin America, Asia, the Middle East, Africa, and the Caribbean;
- The ability to make calls between any combination of computers, Internet connected telephones, wireless devices, and other SIP-enabled hardware;
- An international partnership and distribution model, which provides for faster service deployment, reduced capital requirements and cost-efficient service delivery; and
- A strategy of using local partners to enable us to access new markets, secure or obtain communication licenses, enhance distribution and provide local customer support.

At this time, we are unable to provide quantified disclosure regarding our market share in the markets in which we operate. As is common with emerging markets, the aggregate market for our products and services is usually not known until feasibility studies containing a wide range of demographic variables are conducted. We are not aware of any studies that presently exist which provide sufficient data for us to determine our market share.

Government Regulation

Generally, in the United States, we are subject to varying degrees of federal, state and local regulation and licensing, including that of the Federal Communications Commission. Internationally we also encounter similar regulations from foreign governments and their telecommunications/regulatory agencies. At each of these levels, there are significant regulations, fees and taxes imposed on the provision of telecommunications services.

We cannot assure that the applicable U.S. and foreign regulatory agencies will grant required authority or refrain from taking action against us if we are found to have provided services without obtaining the necessary authorizations or pursuant to applicable regulations. If authority is not obtained or if our pricing, and/or terms or conditions of service, or required filings are not filed, or are not updated, or otherwise do not fully comply with the rules of these agencies, third parties or regulators could challenge these actions and we could be subject to forfeiture of our license, penalties, fines, fees and/or costs.

The U.S. Federal Government and state authorities have the power to revoke our regulatory approval to operate internationally, interstate, or intrastate, or to impose financial penalties, statutory interest and require us to pay back taxes or fees if we fail to pay, or are delinquent in paying, telecommunications taxes or regulatory fees or fail to file necessary tariffs or mandatory reports. We have been delinquent in such financial, filing and reporting obligations and required filings in the past including, but not limited to, Federal Communications Commission and Universal Service Fund reports and payments.

During July 2004, the United States Senate continued to consider how it might apply regulations to VoIP. The VoIP Regulatory Freedom Act of 2004 exempts VoIP service from state taxes and regulations and defines it as a lightly regulated information service for U.S. government regulators. This does not, however, remove the uncertainty of regulatory impact within the United States. For example, the bill reserves the ability for states to require VoIP to provide 911 services, to require VoIP providers to contribute to state universal service programs, and to pay intrastate access charges to other telecom providers.

On April 24, 2004, the FCC rendered a decision on the AT&T Petition for Declaratory Ruling (WC Docket No. 02-361) pending before them. The FCC determined that where 1+ calls were made from regular telephones, converted into an Internet protocol format, transported over the AT&T Internet backbone, and then converted back from IP format and delivered to the called party through the local exchange carriers' local business lines (not Feature Group D trunks), the service was a "telecommunications service" for which terminating access charges were due the local exchange carrier. In its decision, the Commission stated that, under the current rules, the service provided by AT&T is a "telecommunications service" upon which interstate access charges may be assessed against AT&T. The FCC limited its decision to the specific facts of the AT&T case where the type of service involved ordinary Customer Premise Equipment (CPE) with no enhanced functionality, the calls originated and terminated on the public switched telephone network, and the calls underwent no net protocol conversion and provided no enhanced functionality to the end user due to the provider's use of Internet protocol technology. In fact, in the AT&T case the customer was completely unaware of AT&T's use of IP technology in transporting the call.

Although the FCC determined the services provided by AT&T to be a telecommunications service subject to interstate access charges rather than information services not subject to such charges, they did not make a determination regarding the regulatory status of phone-to-phone VoIP or its exposure to Universal Service Fund (USF), 911, Communications Assistance for Law Enforcement Act (CALEA) or any other public policy issues. The FCC further qualified the decision by stating that they "in no way intend to preclude the Commission from adopting a different approach when it resolves the IP-Enabled Services rulemaking proceeding or the Intercarrier Compensation rule making proceeding." (Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) (Intercarrier Compensation)).

In June 2005, the FCC imposed 911 obligations on providers of "interconnected" VoIP services.

In addition, the FCC requires interconnected VoIP providers to register with the FCC, comply with the Communications Assistance for Law Enforcement Act of 1994 (CALEA) and to contribute to the Universal Service Fund.

We do not believe that we are an "interconnected" VoIP service provider under the FCC definition and, therefore, do not fall under the regulatory requirements set forth above. If the FCC determines we are an "interconnected" VoIP service provider and have not registered as such, or are not compliant under the regulations, third parties or regulators could challenge these actions and we could be subject to penalties, fines, fees and/or costs. In addition, emerging technology could cause us to change our product and service configuration or the FCC definition could be changed, and we may become an "interconnected" VoIP provider under the FCC definition in the future. Should this occur, we will be required to comply with the regulations set forth above.

Some states have tried to directly regulate VoIP services on an intrastate basis, but these attempts have, so far, not held up to court challenges. Many states are holding forums to research the issues surrounding VoIP. Some are encouraging or even requesting that VoIP providers subject themselves to public service commission jurisdiction and obtain certification as telephone companies. Most are hesitant to act until a final determination is made by the FCC, but some have voluntarily done so.

We believe VoIP may be subject to additional regulation in the future, it is uncertain when or how the effects of such regulation would affect us, nor is it understood if other countries will seek to follow suit. If additional regulation does occur, the FCC, any state or any country may impose surcharges, taxes or additional regulations upon providers of VoIP. The imposition of any such additional fees, charges, taxes and regulations on Internet protocol service providers could materially increase our costs and may limit or eliminate the competitive pricing we currently enjoy.

Intellectual Property and Trademarks

We have several trademarks and service marks, all of which are of material importance to us.

The following trademarks and service marks are registered with the United States Patent Trademark Office:

1. Fusion Telecommunications International

2. FTI

3. Diamond / Block Logo

4. Diamond Logo

5. Fusion

6. Fusion Telecom

7. efonica (logo)

8. Efonica

The following trademarks and service marks are filed with the United States Patent Trademark Office and are currently in registration process:

1. Fusion (logo)

2. Hear the Difference

3. Efocash

4. Efostore

5. Efofax

6. Efobridge

7. Efolink

8. Efogate

9. Efonicash

10. Efo in

11. Efonifax

12. Efonicall

13. Efo out

14. Efonica (softphone design)

15. The Area Code of the Internet

16. Worldwide Internet Area Code

17. Internet Area Code

18. Efo

19. Fusion Softphone

20. Efonica Softphone

21. Invite a Friend

22. Members Area

23. Callgate

24. Freefonica

25. Enumber

26. Ecash

27. Estore

28. Internet Phone Number

The following trademark application was abandoned by the company because it was no longer used in commerce.

Fusion Tel

The telecommunications and VoIP markets have been characterized by substantial litigation regarding patent and other intellectual property rights. Litigation, which could result in substantial cost to and diversion of our efforts, may be necessary to enforce trademarks issued to us or to determine the enforceability, scope and validity of the proprietary rights of others. Adverse determinations in any litigation or interference proceeding could subject us to costs related to changing names and a loss of established brand recognition. Recently, a competitor of ours, Vonage, was sued by Verizon, for a violation of a number of VoIP related patents. Verizon was awarded substantial monetary damages.

Employees

As of December 31, 2006, we had 86 employees in Fusion Telecommunications International, Inc., and none of our employees are represented by a labor union. We consider our employee relations to be good, and we have never experienced a work stoppage.

Confidentiality Agreements

All our employees have signed confidentiality agreements, and it is our standard practice to require newly hired employees and, when appropriate, independent consultants, to execute confidentiality agreements. These agreements provide that the employee or consultant may not use or disclose confidential information except in the performance of his or her duties for the company, or in other limited circumstances. The steps taken by us may not, however, be adequate to prevent the misappropriation of our proprietary rights or technology.

Revenues and Assets by Geographic Area

During the years ended December 31, 2006 and 2005, 90.4% and 89.5%, respectively, of our revenue was derived from customers in the United States and 9.6% and 10.5%, respectively, from international customers. As of December 31, 2006 and 2005, 2.0% and 5.4%, respectively, of our long-lived assets were located outside of the United States. For more information concerning our geographic concentration, see Note 21 of the Notes to Consolidated Financial Statements included elsewhere in this report.

Available Information

We are subject to the informational requirements of the Securities Exchange Commission and in accordance with those requirements file reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy the reports, proxy statements and other information that we file with the Commission under the informational requirements of the Securities Exchange Act at the Commission's Public Reference Room at 450 Fifth Street N.W., Washington, DC 20549. Please call 1-800-SEC-0339 for information about the Commission's Public Reference Room. The Commission also maintains a web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Commission. The address of the commission's web site is http://www.sec.gov. Our web site is http://www.fusiontel.com. We make available through our web site, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q. Current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Commission. Information contained on our web site is not a part of this report.

Item 1A. Risk Factors

The discussion in this annual report regarding our business and operations includes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1996. Such statements consist of any statement other than a recitation of historical fact and can be identified by the use of forward-looking terminology such as "may," "expect," "anticipate," "intend," "estimate" or "continue" or the negative thereof or other variations thereof or comparable terminology. The reader is cautioned that all forward-looking statements are speculative, and there are certain risks and uncertainties that could cause actual events or results to differ from those referred to in such forward-looking statements. This disclosure highlights some of the important risks regarding our business. The number one risk of the Company is its ability to attract fresh and continued capital to execute its comprehensive business strategy. In addition, the risks included should not be assumed to be the only things that could affect future performance. Additional risks and uncertainties include the potential loss of contractual relationships, changes in the reimbursement rates for those services as well as uncertainty about the ability to collect the appropriate fees for services provided by us. Also, the Company faces challenges in technology development and use. We may also be subject to disruptions, delays in collections, or facilities closures caused by potential or actual acts of terrorism or government security concerns.

Risks Related to Business

We have a history of operating losses and, prior to our IPO, a working capital deficit and stockholders' deficit. There can be no assurance that we will ever achieve profitability or have sufficient funds to execute our business strategy.

There can be no assurance that any of our business strategies will be successful or that we will ever achieve profitability. At December 31, 2006, we had a working capital deficit of approximately ($2.7) million and stockholders' equity of approximately $13.4 million. We have continued to sustain losses from operations and for the years ended December 31, 2006, 2005 and 2004, we have incurred a net loss applicable to common stockholders of approximately $13.4 million, $9.4 million, and $5.4 million, respectively. In addition, we have not generated positive cash flow from operations for the years ended December 31, 2006, 2005 and 2004. We may not be able to generate future profits and may not be able to support our operations, or otherwise establish a return on invested capital. In addition, we may not have sufficient funds to execute our business strategy, requiring us to raise funds from capital markets, consequently, diluting our common stock.

If we are unable to manage our growth or implement our expansion strategy, we may increase our costs without maximizing our revenues.

We may not be able to expand our product offerings, our client base and markets, or implement the other features of our business strategy at the rate or to the extent presently planned. Our projected growth will place a significant strain on our administrative, operational and financial resources and may increase our costs. If we are unable to successfully manage our future growth, establish and continue to upgrade our operating and financial control systems, recruit and hire necessary personnel or effectively manage unexpected expansion difficulties, we may not be able to maximize revenues or profitability.

The success of our planned expansion is dependent upon market developments and traffic patterns, which will lead us to make expenditures that may not result in increased revenues.

Our purchase of network equipment and software will be based in part on our expectations concerning future revenue growth and market developments. As we expand our network, we will be required to make significant capital expenditures, including the purchase of additional network equipment and software, and to add additional employees. To a lesser extent our fixed costs will also increase from the ownership and maintenance of a greater amount of network equipment including our Softswitch, gateways, routers, satellite equipment, and other related systems. If our traffic volume were to decrease, or fail to increase to the extent expected or necessary to make efficient use of our network, our costs as a percentage of revenues would increase significantly.

We may be unable to adapt to rapid technology trends and evolving industry standards, which could lead to our products becoming obsolete.

The communications industry is subject to rapid and significant changes due to technology innovation, evolving industry standards, and frequent new service and product introductions. New services and products based on new technologies or new industry standards expose us to risks of technical or product obsolescence. We will need to use technologies effectively, continue to develop our technical expertise and enhance our existing products and services in a timely manner to compete successfully in this industry. We may not be successful in using new technologies effectively, developing new products or enhancing existing products and services in a timely manner or that any new technologies or enhancements used by us or offered to our customers will achieve market acceptance.

We are pursuing new lines of business, and introducing new services. In some cases, the technology for these services and/or the market for those services are untested. There can be no assurance of our ability to introduce future services on a timely basis or our ability to derive significant revenues from them.

Our ability to deploy new products and services may be hampered by technical and operational issues which could delay our ability to derive profitable revenue from these service offerings. Additionally, our ability to market these services may prove more difficult than anticipated, including factors such as our ability to competitively price such services. There can be no assurance that we will be able to introduce our planned future services, or that we will be able to derive significant revenue from them.

Our new services are dependent upon multiple service platforms, network elements, and back-office systems, as well as the successful integration of these items. There can be no assurance of the success of this development and integration.

We have completed the initial infrastructure build out of our major network elements and are currently integrating and testing our new services. We cannot ensure that these services will perform as expected. Our ability to effectuate our business plan is dependent on the successful rollout of our services.

We are also developing and deploying back-office systems and services platforms that will enable us to offer our customers a wide-array of new services and features including subscription-based calling plans, conferencing, and unified messaging. There can be no assurance that these developmental efforts will be completed on time or produce the desire results.

There can be no assurance that the planned migration of existing VoIP service customers onto our new infrastructure will be successful.

We will be moving existing VoIP service customers onto our new infrastructure. We cannot ensure that we will be successful in moving these customers to the new infrastructure. The failure to successfully transition these customers onto our new infrastructure could result in the loss of those existing customers and negatively impact our ability to acquire new customers.

If our information and processing systems for billing and client service are not properly implemented, it could harm our ability to bill and provide services effectively.

Sophisticated back office information and processing systems are vital to our growth and our ability to monitor costs, bill clients, provision client orders, and achieve operating efficiencies. Our plans for the development and implementation of these systems rely, for the most part, on having the capital to purchase and maintain required software, choosing products and services offered by third party vendors, and integrating such products and services with existing systems. We also may require customized systems in order to meet our requirements, which may delay implementation and increase expenses. These systems must also integrate with our network infrastructure. In the event that these systems do not integrate with our network infrastructure, our ability to manage our operational or financial systems will be inhibited. We cannot ensure that they will be implemented at all, or that, once implemented, they will perform as expected. Furthermore, our right to use some of these systems is dependent upon license agreements with third party vendors.

These third-party vendors may cancel or refuse to renew some of these agreements, and the cancellation or non-renewal of these agreements may harm our ability to bill and provide services efficiently.

If we do not operate our Softswitch technology effectively, many of the potential benefits of the new technology may not be realized.

We made a fundamental change in our business operations when we migrated to Softswitch technology. There are inherent risks associated with using such a relatively new technology. We may be required to spend additional time or money on this technology, which could otherwise be spent on developing our services. We have previously experienced problems in the operation of our Softswitch. If we do not operate the technology effectively or if our technical staff and we spend too much time on operational issues, it could result in increased costs without the corresponding benefits.

We may be impacted by current litigation regarding patent infringement.

On March 8, 2007, a jury in the U.S. District Court for the Eastern District of Virginia ruled that Vonage Holdings had infringed on three patents held by Verizon Communications, and ordered Vonage to pay Verizon $58 million plus possible future royalties. The details of the patent infringement are not yet clear, however, the patents related in part to technologies used to connect Internet telephone use to the traditional telephone network. Vonage has appealed the decision. At this point, it is not known what will happen on appeal, or whether there may be a future impact to other VoIP service providers, including us. If we were restricted from using certain VoIP technologies, it could increase our cost of service or preclude us from offering certain current or future services

Breaches in our network security systems may hurt our ability to deliver services and our reputation, and result in liability.

We could lose clients and expose ourselves to liability if there are any breaches to our network security systems, which could jeopardize the security of confidential information stored in our computer systems. In the last four years we experienced two known breaches of network security, which resulted in a temporary failure of network operations. Any network failure could harm our ability to deliver certain services, our reputation and subject us to liability.

Our growth is dependent upon our ability to build new distribution relationships, and to bring on new customers, of which there can be no assurance.

Our ability to grow through quick and cost effective deployment of our VoIP services is dependent upon our ability to identify and contract with local entities that will assist in the distribution of our products. This will include local sales agents that sell our retail, Efonica-branded services, resellers that private label and sell our wholesale VoIP services, and referral entities such as web portals that refer potential customers to us. If we are unable to identify or contract for such distribution relationships, we may not generate the customers or revenues currently envisioned.

Our entry into new markets will rely upon our ability to obtain licenses to operate in those countries, and our ability to establish good working relationships with postal telephone and telegraph companies in order to interconnect to the telephone networks. There can be no assurance of our ability to accomplish either.

The rapid growth of our network and the growth of our international distribution capabilities are dependent upon our ability to apply for and receive licenses to operate in the foreign markets we intend to enter. They are also dependent upon our ability to establish positive working relationships with foreign postal telephone and telegraph companies, and other licensed carriers, and to negotiate and execute the agreements necessary for us to interconnect with their local networks. While we will diligently pursue these relationships, we might not be able to obtain the necessary licenses and interconnections within the time frame envisioned or not at all.

The communications services industry is highly competitive and we may be unable to compete effectively.

The communications industry, including Internet and data services, is highly competitive, rapidly evolving, and subject to constant technological change and intense marketing by providers with similar products and services. We expect that new competitors, as well as gray market operators (operators who arrange call termination in a manner that bypasses the postal telephone and telegraph company, resulting in high margins for the gray market operator and substantially lower revenues for the postal telephone and telegraph company), are likely to join existing competitors in the communications industry, including the market for VoIP, Internet and data services. Many of our current competitors are significantly larger and have substantially greater market presence as well as greater financial, technical, operational, marketing and other resources and experience than we do. In the event that such a competitor expends significant sales and marketing resources in one or several markets we may not be able to compete successfully in such markets. We believe that competition will continue to increase, placing downward pressure on prices. Such pressure could adversely affect our gross margins if we are not able to reduce our costs commensurate with such price reductions. In addition, the pace of technological change makes it impossible for us to predict whether we will face new competitors using different technologies to provide the same or similar services offered or proposed to be offered by us. If our competitors were to provide better and more cost effective services than ours, we may not be able to increase our revenues or capture any significant market share.

Industry consolidation could make it more difficult for us to compete.

Companies offering Internet, data and communications services are, in some circumstances, consolidating. We may not be able to compete successfully with businesses that have combined, or will combine, to produce companies with substantially greater financial, sales and marketing resources, larger client bases, extended networks and infrastructures and more established relationships with vendors, distributors and partners than we have. With these heightened competitive pressures, there is a risk that our revenues may not grow as expected and the value of our common stock could decline.

Our ability to provide services is often dependent on our suppliers and other service providers who may not prove to be effective.

A majority of the voice calls made by our clients are connected through other communication carriers, which provide us with transmission capacity through a variety of arrangements. Our ability to terminate voice traffic in our targeted markets is an essential component of our ongoing operations. If we do not secure or maintain operating and termination arrangements, our ability to increase services to our existing markets, and gain entry into new markets, will be limited. Therefore, our ability to maintain and expand our business is dependent, in part, upon our ability to maintain satisfactory relationships with incumbent and other licensed carriers, Internet service providers, international exchange carriers, satellite providers, fiber optic cable providers and other service providers, many of which are our competitors, and upon our ability to obtain their services on a cost effective basis, as well as the ability of such carriers to carry the traffic we route to their networks or provide network capacity. If a carrier does not carry traffic routed to it, or provide required capacity, we may be forced to route our traffic to, or buy capacity from, a different carrier on less advantageous terms, which could reduce our profit margins or degrade our network service quality. In the event network service is degraded it may result in a loss of customers. To the extent that any of these carriers raise their rates, change their pricing structure, or reduce the amount of capacity they will make available to us, our revenues and profitability may be adversely affected.

We rely on third party equipment suppliers who may not be able to provide us the equipment necessary to deliver the services that we seek to provide.

We are dependent on third party equipment suppliers for equipment, software and hardware components, including Cisco, Nextone and Veraz. If these suppliers fail to continue product development and research and development or fail to deliver quality products or support services on a timely basis, or we are unable to develop alternative sources, if and as required, it could result in our inability to deliver the services that we currently and intend to provide.

We rely on the cooperation of postal telephone and telegraph companies who may hinder our operations in certain markets.

In some cases we will require the cooperation of the postal telephone and telegraph company or another carrier in order to provide services under a license or partnership agreement. In the event the postal telephone and telegraph company or another carrier does not cooperate, our service rollout may be delayed, or the services we offer could be negatively affected. If we acquire a license for a market and the postal telephone and telegraph company or incumbent carrier desires to negatively affect our business in the area, they may be in a position to significantly delay our ability to provide services in that market and ultimately make it not worth pursuing.

If we are unable to develop and maintain successful relationships with our joint venture partners, we could fail in an important market.

We are engaged in certain joint ventures where we share control or management with a joint venture partner. If we are unable to maintain a successful relationship with a joint venture partner, the joint venture's ability to move quickly and respond to changes in market conditions or respond to financial issues can erode and reduce the potential for value creation and return on investment. Further, the joint ventures may restrict or delay our ability to make important financial decisions, such as repatriating cash to us from such joint ventures. This uncertainty with our joint ventures could result in a failure in an important market.

Service interruptions could result in a loss of revenues and harm our reputation.

Portions of our network may be shut down from time to time as a result of disputes with vendors or other issues. Any future network shut downs can have a significant negative impact on revenue and cash flows, as well as hurting our reputation. In addition, there is no assurance that we will be able to quickly resolve disputes, if ever, which could result in a permanent loss of revenues.

Because we do business on an international level we are subject to an increased risk of tariffs, sanctions and other uncertainties that may hurt our revenues.

There are certain risks inherent in doing business internationally, especially in emerging markets, such as unexpected changes in regulatory requirements, the imposition of tariffs or sanctions, licenses, customs, duties, other trade barriers, political risks, currency devaluations, high inflation, corporate law requirements, and even civil unrest. Many of the economies of these emerging markets are weak and volatile. We may not be able to mitigate the effect of inflation on our operations in these countries by price increases, even over the long-term. Further, expropriation of private businesses in such jurisdictions remains a possibility, whether by outright seizure by a foreign government or by confiscatory tax or other policies. Deregulation of the communications markets in developing countries may not continue. Incumbent providers, trade unions and others may resist legislation directed toward deregulation and may resist allowing us to interconnect to their network switches. The legal systems in emerging markets frequently have insufficient experience with commercial transactions between private parties. Consequently, we may not be able to protect or enforce our rights in any emerging market countries. Governments and regulations may change resulting in availability of licenses and/or cancellations or suspensions of operating licenses, confiscation of equipment and/or rate increases. The instability of the laws and regulations applicable to our businesses and their interpretation and enforcement in these markets could materially and adversely affect our business, financial condition, or results of operations.

Regulatory treatment of VoIP outside the United States varies from country to country. Some countries including the U.S. are considering subjecting VoIP services to the regulations applied to traditional telephone companies and they may assert that we are required to register as a telecommunications carrier in that country or impose other regulations. In such cases, our failure to register could subject us to fines, penalties, or forfeiture. Regulatory developments such as these could have a material adverse effect on our international operations.

The success of our business depends on the acceptance of the Internet in emerging markets that may be slowed by limited bandwidth, high bandwidth costs, and other technical obstacles.

The ratio of telephone lines per population, or teledensity, in most emerging countries is low when compared to developed countries. Bandwidth, the measurement of the volume of data capable of being transported in a communications system in a given amount of time, remains very expensive in these regions, especially when compared to bandwidth costs in the United States. Prices for bandwidth capacity are generally set by the government or incumbent telephone company and remain high due to capacity constraints among other things. While this trend tends to diminish as competitors roll out new bypass services, these rollouts may be slow to occur. Further, constraints in network architecture limit Internet connection speeds on conventional dial-up telephone lines, and are significantly less than the up to 1.5 megabits per second connection speed on direct satellite link or digital subscriber lines and cable modems in the United States. These speed and cost constraints may severely limit the quality and desirability of using the Internet in emerging countries and can be an obstacle to us entering emerging markets.

Additional taxation and the regulation of the communications industry may slow our growth, resulting in decreased demand for our products and services and increased costs of doing business.

We could have to pay additional taxes because our operations are subject to various taxes. We structure our operations based on assumptions about various tax laws, U.S. and international tax treaty developments, international currency exchange, capital repatriation laws, and other relevant laws by a variety of non-U.S. jurisdictions. Taxation or other authorities might not reach the same conclusions we reach. We could suffer adverse tax and other financial consequences if our assumptions about these matters are incorrect or the relevant laws are changed or modified.

We are subject to varying degrees of international, federal, state, and local regulation. Significant regulations imposed at each of these levels govern the provision of some or all of our services and affect our business. We cannot assure you that our joint venture partners, or we have, or, will receive the international, United States Federal Communications Commission (“FCC”), or state regulatory approvals they or we require. Nor can we provide you with any assurance that international, FCC or state regulatory authorities will not raise material issues with respect to our compliance with applicable regulations or that the cost of our compliance will not have a materially adverse effect on our revenues and profitability.

The U.S. Federal Government and state authorities have the power to revoke our regulatory approval to operate internationally, interstate, or intrastate, or to impose financial penalties if we fail to pay, or are delinquent in paying, telecommunications taxes or regulatory fees or fail to file necessary tariffs or mandatory reports. We are currently, and have been, delinquent in such financial obligations and required filings in the past. Furthermore, delays in receiving required regulatory approvals or the enactment of new and adverse legislation, regulations or regulatory requirements could also have a materially adverse affect on our condition. In addition, future legislative, judicial and regulatory agency actions could alter competitive conditions in the markets in which we intend to operate, to our detriment.

In addition to new regulations being adopted, existing laws may be applied to the Internet, which could hamper our growth.

New and existing laws may cover issues that include: sales and other taxes; user privacy; pricing controls; characteristics and quality of products and services; consumer protection; cross-border commerce; copyright, trademark and patent infringement; and other claims based on the nature and content of Internet materials. This could delay growth in demand for our products and services and limit the growth of our revenue.

Risks Related to our Common Stock

Voting Control by Principal Stockholders

As of March 31, 2007, our executive officers and directors collectively control approximately 33.2% of our outstanding common stock and, therefore are able to significantly influence the vote on matters requiring stockholder approval, including the election of directors.

We Do Not Intend to Pay Dividends on Common Stock.

We have never declared or paid any cash dividends on our common stock. We intend to retain any future earnings to finance our operations and to expand our business and, therefore, do not expect to pay any cash dividends in the foreseeable future.

Item 2. Properties

We are headquartered in New York, New York and lease offices and space in a number of locations. Below is a list of our leased offices and space as of March 31, 2007.

Location	Lease Expiration	Annual Rent	Purpose	Approx. Sq. Ft
420 Lexington Avenue, Suite 1718 New York, New York 10170	October 2015	$ 440,000(1)	Lease of principal executive offices	9,000
75 Broad Street New York, New York 10007	March 2010	$ 634,000(2)	Lease of network facilities	15,000
1475 W. Cypress Creek Road Suite 204 Fort Lauderdale, Florida 33309	May 2014	$ 171,000(3)	Lease of network facilities and office space	13,100
Premises GO2- GO3 Building No. 9 Dubai Internet City Dubai, United Arab Emirates	December 2007	$ 87,000	Lease of office space	1,300

(1) This lease is subject to gradual increase to $509,000 from years 2008 to 2015.

(2) This lease is subject to gradual increase to $673,000 from years 2008 to 2010.

(3) This lease is subject to gradual increase to $215,000 from years 2008 to 2014.

We believe that our leased facilities are adequate to meet our current needs and that additional facilities are available to meet our development and expansion needs in existing and projected target markets.

Item 3. Legal Proceedings

On May 28, 2003, Jack Grynberg, et al., an investor in one of our private offerings, filed a complaint with the Denver District Court, State of Colorado (*Jack Grynberg, et al v. Fusion Telecommunications International, Inc., et al*, 03-CV-3912) seeking damages in the amount of $400,000 for the purchase of an interest in Fusion's 1999 private placement offering of subordinated convertible notes through Joseph Stevens & Company, Inc., a registered broker dealer. This complaint asserted the following claims for relief against us: Breach of Fiduciary Duty, Civil Theft, Deceptive Trade Practices, Negligent Misrepresentation, Deceit Based on Fraud, Conversion, Exemplary Damages and Prejudgment Interest. On June 25, 2004, we filed with the Court our Motion to Dismiss, which was granted. The Company was awarded attorneys' fees by the court. A written order of Judgment in favor of the Company and against the plaintiff in the amount of approximately $40,000 was recorded on January 24, 2006. The plaintiffs have filed an appeal of the motion, which is still pending as of the date of this filing.

On March 30, 2006, an equipment vendor filed a complaint with the Circuit Court in Broward County, State of Florida, seeking damages in the amount of approximately $1,380,000 allegedly due on two promissory notes plus accrued interest through March 1, 2006 and attorney costs. Management asserted a counterclaim against the vendor, which was settled subsequent to year end resulting in the amendment of an existing contract with the vendor. Our legal counsel has advised that, at this stage, they cannot accurately predict the likelihood of an unfavorable outcome or quantify the amount or range of potential loss, if any. Accordingly, with the exception of amounts previously accrued by us under the capital lease arrangement, no adjustment that may result from resolution of these uncertainties has been made in our accompanying financial statements.

The Company is currently undergoing an audit by New York State for franchise and excise taxes, which has not yet been concluded and may result in an indeterminate amount of tax liability, not previously accrued for.

On or about February 9, 2007, we filed a complaint against Patrick S. Dallas, InfoTel Holdings, Ltd., Phil Walton and John Does 1-5 in the Supreme Court of the State of New York (*Fusion Telecommunications International, Inc. vs. Patrick S. Dallas, et al.,* Index No. 2007001836) seeking damages associated with Mr. Dallas' sale of Convergent Technologies Ltd. Stock to us and InfoTel's breach of its October 2006 agreement to purchase Fusion Jamaica Limited's equipment in Jamaica and assume the real property lease in Jamaica. We believe Mr. Dallas owns or controls InfoTel. This complaint asserted the following claims for relief: Breach of Contract (the Stock Purchase Agreement); Breach of Mr. Dallas' Employment Agreement; Breach of Mr. Dallas' Non-Solicitation and Non-Compete Agreement; Breach of Contract (the InfoTel Agreement); Diversion and Waste of Corporate Assets; Conversion: Scheme to Defraud and Deceive and Demand for Accounting; Fraudulent Misconduct with Intent to Defraud (the Stock Purchase Agreement); Fraudulent Misconduct with Intent to Defraud (the InfoTel Agreement); Indemnification (the Stock Purchase Agreement); and Indemnification (the InfoTel Agreement). Our legal counsel has advised that, at this state, they cannot accurately predict the likelihood of an unfavorable outcome, or quantify the amount or range of damages we would be entitled to receive if we prevail.

The Company is involved in other claims and legal actions arising in the normal course of business. Management does not expect that the outcome of these cases will have a material effect of the Company's financial position.

Due to the regulatory nature of the industry, the Company is periodically involved in various correspondence and inquiries from state and federal regulatory agencies. Management does not expect the outcome on these inquiries to have a material impact on our operations or financial condition.

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

There were no matters submitted to a vote of security holders in the fourth quarter of the fiscal year ended December 31, 2006.

PART II

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

Market Information

Our common stock is currently listed on the American Stock Exchange under the symbol "FSN", and our redeemable common stock purchase warrants are listed on the American Stock Exchange under the symbol "FSN.WS".

Prior to February 15, 2005, there was no established trading market for our common stock and redeemable common stock warrants.

Common Stock

Year Ended December 31, 2006	High	Low
First Quarter	$ 3.40	$ 2.45
Second Quarter	$ 3.47	$ 1.99
Third Quarter	$ 2.52	$ 1.45
Fourth Quarter	$ 1.90	$ 1.01

Year Ended December 31, 2005	High	Low
First Quarter	$ 7.70	$ 4.90
Second Quarter	$ 5.11	$ 4.05
Third Quarter	$ 4.70	$ 3.51
Fourth Quarter	$ 3.70	$ 2.30

Redeemable Common Stock Purchase Warrants

Year Ended December 31, 2006	High	Low
First Quarter	$ 0.65	$ 0.30
Second Quarter	$ 0.50	$ 0.22
Third Quarter	$ 0.41	$ 0.16
Fourth Quarter	$ 0.35	$ 0.07

Year Ended December 31, 2005	High	Low
First Quarter	$ 1.42	$ 0.85
Second Quarter	$ 0.95	$ 0.45
Third Quarter	$ 0.64	$ 0.40
Fourth Quarter	$ 0.53	$ 0.23

On March 26, 2007, the last reported sale price for our common stock on the American Stock Exchange was $0.64 per share and the last reported sale price for our redeemable common stock purchase warrants were $0.07 per warrant. The market price for our stock and warrants is highly volatile and fluctuates in response to a wide variety of factors.

Holders

As of March 26, 2007, we had approximately 2,158 holders of record of our common stock and 1,476 holders of record of our redeemable common stock purchase warrants. This does not reflect persons or entities that hold their stock in nominee or "street" name through various brokerage firms.

Dividend Policy

We have never declared or paid any cash dividends on our common stock. We do not anticipate paying any cash dividends on our common stock in the foreseeable future. We currently intend to retain future earnings, if any, to finance our operations and to expand our business. Any future determination to pay cash dividends will be at the discretion of our board of directors and will be dependent upon our financial condition, operating results, capital requirements and other factors that our board of directors considers appropriate.

Issuer Purchases of Equity Securities

There have been no purchases of equity securities by the Company required to be disclosed herein.

Use of Proceeds

In December 2006, the Company completed the first phase of a private placement for the purpose of raising working capital for the Company's operations. The private placement provided for the issuance of a maximum of 10,000 shares of the Company's newly designated Preferred Stock, Series A-1 at $1,000 per share. The total number of shares of Preferred Stock Series A-1 issued in this private placement was 3,875 shares, for which net proceeds of approximately $3.8 million were received and are being used for working capital. As of December 31, 2006, approximately $1.1 million of the net proceeds received by the Company had been used to fund operations.

Equity Compensation Plans

The following table provides certain aggregate information with respect to all of our equity compensation plans in effect for year ended December 31, 2006:

Plan Category	Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance
Equity compensation plans approved by security holders	2,832,546	$ 3.54	1,167,454
Total	2,832,546	$ 3.54	1,167,454

Item 6. Selected Financial Data

The following table sets forth selected historical financial data as of and for each of the periods ended December 31, 2006, 2005, 2004, 2003 and 2002. The selected financial data are derived from the audited consolidated financial statements of Fusion Telecommunications International, Inc. The consolidated financial statements, and the report thereon, as of December 31, 2006 and 2005, and for the three year period ended December 31, 2006 which are included elsewhere in this Annual Report on Form 10-K. The following financial information should be read in conjunction with "Management's Discussion and Analysis and Results of Operations" and our consolidated financial statements and related notes appearing elsewhere in this Annual Report.

	Years Ended December 31,				
	2006	2005	2004	2003	2002
Revenues	$ 47,087,064	$ 49,364,542	$ 49,557,973	$ 32,018,471	$ 25,537,163
Operating expenses:					
Cost of revenues	42,463,724	45,048,917	42,927,994	27,855,508	23,638,447
Depreciation and amortization	1,397,094	1,510,172	1,804,184	1,981,805	2,361,495
Loss on impairment	867,212	—	—	375,000	467,765
Selling, general and administrative expenses	14,803,062	11,633,713	9,722,719	8,543,664	9,607,160
Advertising and marketing	1,335,745	175,725	81,686	32,143	19,000
Total Operating Expenses	60,866,837	58,368,527	54,536,583	38,788,120	36,093,867
Operating loss	(13,779,773)	(9,003,985)	(4,978,610)	(6,769,649)	(10,556,704)
Other income (expense):					
Interest income	318,333	474,109	26,428	12,227	(21,501)
Interest expense	(114,006)	(434,749)	(2,254,488)	(859,123)	(1,036,844)
Gain (loss) on settlements of debt	465,854	(75,927)	2,174,530	3,918,295	1,812,092
Loss from investment in Estel	(185,234)	(541,876)	(519,728)	(746,792)	326,367
Other	44,801	(195,006)	(15,965)	(97,766)	98,626
Minority interests	67,694	175,353	(7,654)	157,617	19,440
Total other income (expense)	597,442	(598,096)	(596,877)	2,384,458	1,198,180
Loss from continuing operations	(13,182,331)	(9,602,081)	(5,575,487)	(4,385,191)	(9,358,524)
Discontinued operations:					
Income (loss) from discontinued operations	(168,871)	207,007	545,215	208,620	—
Net loss	$ (13,351,202)	$ (9,395,074)	$ (5,030,272)	$ (4,176,571)	$ (9,358,524)
Losses applicable to common stockholders:					
Loss from continuing operations	$ (13,182,331)	$ (9,602,081)	$ (5,575,487)	$ (4,385,191)	$ (9,358,524)
Preferred stock dividends	—	—	(385,918)	(635,254)	(642,552)
Net loss applicable to common stockholders from continuing operations:	(13,182,331)	(9,602,081)	(5,961,405)	(5,020,445)	(10,001,076)
Income (loss) from discontinued operations	(168,871)	207,007	545,215	208,620	—
Net loss applicable to common stockholders	$ (13,351,202)	$ (9,395,074)	$ (5,416,190)	$ (4,811,825)	$ (10,001,076)
Basic and diluted net loss per common share:					
Loss from continuing operations	$ (0.49)	$ (0.39)	$ (0.35)	$ (0.37)	$ (1.01)
Income (loss) from discontinued operations	(0.01)	0.01	0.03	0.02	—
Net loss applicable to common stockholders	$ (0.50)	$ (0.38)	$ (0.32)	$ (0.35)	$ (1.01)
Weighted average shares outstanding					
Basic and diluted	26,737,083	24,965,080	16,707,114	13,616,803	9,885,901

	Years Ended December 31,				
	2006	2005	2004	2003	2002
Operating data:					
Capital expenditures	$ (3,299,198)	$ (1,877,252)	$ (627,219)	$ (582,149)	$ (427,057)
Summary Cash Flow Data:					
Net cash used in operating activities	(11,343,665)	(7,980,651)	(4,874,834)	(4,884,543)	(4,265,500)
Net cash used in investing activities	(3,693,097)	(2,396,445)	(250,460)	(744,071)	(983,453)
Net cash provided by financing activities	2,989,413	20,798,874	6,288,375	8,097,832	5,985,380
Balance Sheet Data (at period end):					
Cash	$ 2,743,155	$ 14,790,504	$ 4,368,726	$ 3,205,645	$ 736,427
Restricted cash	781,566	218,176	380,276	736,626	1,051,182
Property and equipment	14,262,669	12,214,290	11,022,330	10,078,806	10,623,109
Property and equipment, net	6,422,016	4,270,966	3,271,474	3,743,293	5,649,787
Total assets	27,573,300	34,385,779	13,662,117	11,681,625	10,992,016
Total debt	1,216,746	1,577,615	5,687,631	4,644,904	9,151,925
Redeemable preferred stock	—	—	9,716,026	3,466,538	—
Total stockholders' equity (deficit)	$ 13,445,958	$ 17,721,641	$ (13,290,029)	$ (9,866,927)	$ (14,867,407)

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our financial condition and results of operations should be read together with our consolidated financial statements and the related notes thereto included in another part of this Annual Report. This discussion contains certain forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve substantial risks and uncertainties. When used in this report the words "anticipate," "believe," "estimate," "expect" and similar expressions as they relate to our management or us are intended to identify such forward-looking statements. Our actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements. Historical operating results are not necessarily indicative of the trends in operating results for any future period.

Overview

We are an international telecommunications carrier delivering VoIP services, private network, Internet access, and other advanced services to, from, in and between emerging markets in Asia, the Middle East, Africa, Latin America, and the Caribbean. Our corporate strategy focuses our resources on customizing VoIP services to meet the demands of international communities of interest in emerging markets around the world. We seek to gain early entry in high growth emerging markets, often in partnership with local organizations that have strong distribution channels, regulatory experience, market intelligence, the ability to deliver local loops and the capability of providing customer service support. This approach enables us to introduce our Internet protocol telecommunications services in these markets, thereby benefiting from the time-to-market advantages, expanded geographic reach and reduced capital requirements that local partnerships afford. Additionally, we have built a carrier grade retail infrastructure to expand our VoIP service and feature options and to better support the growth of our VoIP services to consumers and corporations.

The following table summarizes our results of operations for the periods indicated:

	Years Ended December 31, 2006	2005	2004
Revenues	$ 47,087,064	$ 49,364,542	$ 49,557,973
Operating expenses:			
Cost of revenues	42,463,724	45,048,917	42,927,994
Depreciation and amortization	1,397,094	1,510,172	1,804,184
Loss on impairment	867,212	—	—
Selling, general and administrative	14,803,062	11,633,713	9,722,719
Advertising and marketing	1,335,745	175,725	81,686
Total operating expenses	60,866,837	58,368,527	54,536,583
Operating loss	(13,779,773)	(9,003,985)	(4,978,610)
Other income (expense):			
Interest income	318,333	474,109	26,428
Interest expense	(114,006)	(434,749)	(2,254,488)
Gain (loss) on settlements of debt	465,854	(75,927)	2,174,530
Loss from investment in Estel	(185,234)	(541,876)	(519,728)
Other	44,801	(195,006)	(15,965)
Minority interests	67,694	175,353	(7,654)
Total other income (expense)	597,442	(598,096)	(596,877)
Loss from continuing operations	(13,182,331)	(9,602,081)	(5,575,487)
Loss from discontinued operations	(168,871)	207,007	545,215
Net loss	$ (13,351,202)	$ (9,395,074)	$ (5,030,272)

The following table presents our historical operating results as a percentage of revenues for the periods indicated:

	Years Ended December 31, 2006	2005	2004
Revenues	100.0%	100.0%	100.0%
Operating expenses:			
Cost of revenues	90.2%	91.3%	86.6%
Depreciation and amortization	3.0%	3.1%	3.6%
Loss on impairment	1.8%	0.0%	0.0%
Selling, general and administrative	31.4%	23.6%	19.6%
Advertising and marketing	2.8%	0.4%	0.2%
Total operating expenses	129.2%	118.4%	110.0%
Operating loss	(29.2)%	(18.4)%	(10.0)%
Other income (expense):			
Interest income	0.7%	1.0%	0.1%
Interest expense	(0.2)%	(0.9)%	(4.5)%
Gain (loss) on settlement of debt	1.0%	(0.2)%	4.4%
Loss from investment in Estel	(0.4)%	(1.1)%	(1.0)%
Other	0.1%	(0.4)%	0.0%
Minority interests	0.1%	0.4%	0.0%
Total other income (expense)	1.3%	(1.2)%	(1.2)%
Loss from continuing operations	(27.9)%	(19.6)%	(11.3)%
Loss from discontinued operations	(0.4)%	0.4%	1.1%
Net loss	(28.3)%	(19.2)%	(10.2)%

Revenues

Historically, we have generated the majority of our revenues from voice traffic sold to other carriers, with a primary focus in the last several years on VoIP terminations to the emerging markets. We focus on growing our existing customer base, which is primarily U.S. based, as well as the addition of new customers, and the establishment of direct VoIP terminating arrangements with telecommunication carriers in emerging markets and around the world. Although we believe that this business continues to be of value to our strategy, ongoing competitive and pricing pressures have caused us to increase our focus on higher margin, value-added services (primarily VoIP to consumers and corporations), and market them to, or in conjunction with, distribution partners on a direct, co-branded or private label basis.

In an effort to further increase margins, expand our retail customer base, and develop more stable revenue streams, we have begun to focus significant effort and resources to build our VoIP business to consumers and corporations. While this does not yet represent a significant portion of our revenue base, we expect to continue to increase our emphasis in this area. We believe that this will complement our carrier business with a higher margin and more stable customer base.

In 2002, we established Efonica F-Z, LLC, as a retail services company marketing VoIP products to consumer and corporate customers in emerging markets. Beginning in the Middle East, Asia and Africa, then extending into Latin America, Efonica's services are primarily sold through distribution channels on a pre-paid basis. Efonica's customers can place calls from anywhere in the world to any destination using a personal computer, Internet protocol telephone or regular telephone when accompanied by a hardware device that may be purchased through Efonica. We believe that the introduction of advanced features such as voicemail, call waiting and call forwarding will enhance this value-added offering. In February 2005, we closed on the purchase of the 49.8% minority interest in Efonica.

We manage our revenues by product and customer. We manage our costs by provider (vendor). We track total revenue at the customer level because our sales force has to manage the revenue generation at the customer level, and invoices are billed to and collected at the customer level. We also have to track the same revenues by product, because different products have different billing and payment terms, and individual customers may have multiple billing and payment terms if they purchase multiple products from us.

We manage our revenue segments based on gross margin, which is net revenues less cost of revenues, rather than on net profitability, due to the fact that our infrastructure is built to support all products, rather than individual products. This applies both to the capital investments made (such as switching and transmission equipment), and to Selling, General and Administrative resources. The majority of our sales and operations personnel support all product lines within their market segment, i.e. carrier, and are not separately hired to support individual product segments. For segment reporting purposes, all expenses below cost of revenues are allocated based on percentage of utilization of resources unless the items can be specifically identified to one of the product segments.

Operating Expenses

Our operating expenses are categorized as cost of revenues, depreciation and amortization, loss on impairment, selling, general and administrative expenses, and advertising and marketing.

Cost of revenues includes costs incurred with the operation of our leased network facilities, and the purchase of voice termination and Internet protocol services from other telecommunications carriers and Internet service providers. We continue to work to lower the variable component of the cost of revenue through the use of least cost routing, and continual negotiation of usage-based and fixed costs with domestic and international service providers.

Depreciation and amortization includes depreciation of our communications network equipment, amortization of leasehold improvements of our switch locations and administrative facilities, and the depreciation of our office equipment and fixtures. In 2006, it also includes amortization of the Efonica customer list.

Selling, general and administrative expenses include salaries and benefits, commissions, occupancy costs, sales, professional fees and other administrative expenses.

Advertising and marketing expense includes cost for promotional materials for the marketing of our retail products and services, as well as for public relations.

Company Highlights

The following summary of significant events during the two years ended December 31, 2006, highlights the accomplishments and events that have influenced our performance during that time period.

2006

- ***Licensed Market-Leading Technology*** - Licensed Global IP Sound's market-leading technology to power its VoIP softphone;
- ***Filed Patent Application*** - Filed patent application for our proprietary VoIP technology for SIP peer-to-peer VoIP communication;
- ***Completion of Softphone Development*** - Completed development of our proprietary PC-based VoIP softphone, which allows us to differentiate our Efonica® VoIP offering;
- ***Launched Free Internet Service*** - Launched new free Internet phone service, which allows Efonica® subscribers worldwide to make free calls without computers. We also created the Worldwide Internet Area Code™ which allows subscribers to use their existing telephone numbers preceded by a "10";
- ***Filed for Patent for Worldwide Internet Area Code*** - Filed patent application for Worldwide Internet Area Code™;
- ***Introduction of EFO Out*** - We introduced one of our new paid services, EFO Out, which allows users to call any landline or mobile telephone number in the world at extremely competitive prices;
- ***Jinti Partnership*** - Entered into a strategic partnership with Jinti, a rapidly growing Chinese community services site that currently attracts in excess of 3 million unique visitors from China each month;
- ***Marketing Alliance with MasterCard worldwide*** - We entered into a retail marketing alliance with MasterCard Worldwide to offer our suite of premium paid VoIP communication services to MasterCard cardholders;
- ***Efonica subscribers exceed 1,000,000*** - Since launching our new Efonica VoIP service on June 19, 2006, we have registered more than one million subscribers;
- ***Efonica Services in Jordan*** - Introduction of our Efonica VoIP services in Jordan to allow us to continue to connect communities worldwide, due to our securing exclusive rights to a Jordanian Telecommunications License;
- ***Introduction of Mobilink*** - Launched revolutionary new Mobilink Service, which offers U.S. consumers access to VoIP services from their mobile phones, without Internet access or special software; and
- ***Consummation of Private Placement*** - In December 2006, we consummated a $3.875 million private placement of a newly designated class of convertible preferred stock. Participating were a group of investors including Fusion's Chairman, its CEO and each of the other nine members of the Board of Directors.

2005

- ***Capital Fund-Raising*** - In February 2005, we closed on our initial public offering of securities of 3,600,000 shares of common stock at a price of $6.45 per share and 3,600,000 redeemable common stock purchase warrants at $.05 per warrant. Net proceeds of the offering were approximately $20.4 million. On March 30, 2005, our underwriters exercised their over-allotment option and purchased an additional 480,000 shares of common stock and 540,000 purchase warrants. We received an additional $2.9 million in net proceeds from the closing on the over-allotment option;
- ***Debt Reduction*** - Upon completion of our IPO we repaid approximately $1.5 million in outstanding debt. In addition, $2.5 million of convertible debt was converted into 651,515 shares of common stock. During May 2005, we repaid an additional $0.2 million of debt;
- ***Conversion of Series C Preferred Stock*** - The $10.0 million liability related to the 109,962 shares of outstanding Series C Preferred Stock was converted into equity (3,141,838 shares of common stock);

- ***VoIP to Consumers and Corporations Revenue Growth*** - Revenue in our retail VoIP to consumers and corporations segment grew 8% during 2005 over 2004. This segment's revenue is expected to increase significantly once our paid VoIP products and services are rolled out; and

- ***Purchase of Efonica*** - In February 2005, we acquired the remaining 49.8% interest in our Efonica joint venture.

Year Ended December 31, 2006 Compared with Year Ended December 31, 2005.

Revenues

Consolidated revenues were $47.1 million for 2006 compared to $49.4 million for 2005, a decrease of 4.6%.

Revenues for voice services sold to carriers remained relatively constant year over year, at $43.6 million for both 2006 and 2005. Although there was no increase in the year over year comparison, there had been an unusually high peak in the second quarter of 2005 that was an anomaly. Carrier revenues have consistently increased quarter over quarter since that peak period.

Revenues for consumers, corporations and other decreased from $5.8 million in 2005 to $3.4 million in 2006. The decrease was mainly due to technical difficulties encountered in the development of our Efonica retail services platform, which held back the growth of this segment, and also due to the cancellations of government contracts. We expect the technical issues with the new retail VoIP platform to be resolved during this year, and we expect this segment's revenues to grow significantly during the next few years.

Cost of Revenues

Consolidated cost of revenues improved by $2.6 million, or 5.7%, decreasing from $45.0 million in 2005 to $42.5 million in 2006. Approximately $1.0 million of this decrease was attributable to an improvement in efficiencies of route management for voice services to carriers. The remaining decrease in cost of revenues was attributable to a decrease in revenues for consumers, corporations and other.

Consolidated gross margin increased $0.3 million for 2006 over 2005. Gross margin for voice services to carriers increased by $1.1 million, but was partially offset by a decrease in the gross margin for consumers, corporations and other.

Operating Expenses

Depreciation and Amortization. Depreciation and amortization decreased to $1.4 million during the year ended 2006 from $1.5 million, or 7.5%, during the year ended 2005. Our depreciation decreased as a result of many our assets being fully depreciated during all or a part of 2006.

Selling, General and Administrative. Selling, general and administrative expenses increased $3.2 million or 27.2% to $14.8 million during 2006, from $11.6 million during 2005. This increase is primarily attributed to increased salaries and benefits, as more personnel have been required to support the growth and expansion of our infrastructure. In addition, contributing to the 2006 increase is approximately $0.7 million of compensation expense recorded in connection with our adoption of SFAS123(R) on January 1, 2006. Our professional fees have also increased as a result of our growth and our becoming a public company in February 2005, including expenses associated with Sarbanes Oxley, travel related expenses, occupancy costs, and insurance expenses. However, we are taking strong measures to reduce our expenses, and believe that as we execute our business strategies, selling, general and administrative expenses as a percentage of revenues will begin to decline.

Advertising and Marketing. Advertising and marketing increased from $0.2 million in 2005 to $1.3 million in 2006, associated with the promotional campaign for the launch of our new retail products and services.

Operating Loss. Our operating loss increased $4.8 million or 53% to a loss of $13.8 million during 2006, from a loss of $9.0 million during 2005. The increase in operating loss was attributable to the items mentioned above, including the decrease in gross margin, the increase in selling, general and administrative expenses associated with our retail infrastructure growth, the increase in advertising and marketing for our new retail services, and the increased costs associated with regulatory compliance requirements.

Other Income (Expense). Total other income (expense) changed from a net loss of $0.6 million in 2005 to a net gain of $0.6 million during 2006. During 2006, we had interest expense of $0.1 million in contrast to interest expense of $0.4 million during 2005. The $0.4 million interest expense for 2005 included $0.3 million of accretion since all the Series C Preferred Stock was converted to common stock in connection with our February 2005 IPO. Consequently, accretion ceased and 2005 interest expense only includes accretion for the period between January 1, 2005 and February 17, 2005. A significant portion of this debt was repaid during February 2005 in connection with our IPO. We also had decreased interest income during 2006 of $0.3 million versus $0.5 million during 2005, as cash was used in operating activities. Gain (loss) on debt settlements changed from a net loss of $0.1 million in 2005 to a net gain of $0.5 million during 2006. The 2006 gain on debt forgiveness was attributed to the settlements of vendor obligation. The loss from investment in Estel decreased $0.3 million or 65.8%, from $0.5 million in 2005 to $0.2 million during 2006. Minority interest decreased approximately $0.1 million during 2006 from $0.2 million during 2005. The 2005 minority interests balance is attributed to the losses incurred in connection with our Turkey joint venture.

Discontinued Operations. In 2006 Fusion incurred $0.2 million in loss from discontinued operations associated with its Turkey subsidiary. In 2005 the Company had income of $0.2 million associated with the resolution of certain liabilities associated with previous discontinued operations.

Net Loss. The net loss for 2006 was $13.4 million compared to $9.4 million for 2005. The factors noted above that impacted the net operating loss were partially reduced by the positive other income.

Year Ended December 31, 2005 Compared with Year Ended December 31, 2004.

Revenues

Consolidated revenues remained fairly constant between the two years ($49.4 million during 2005 compared to $49.6 million during 2004). An increase in our revenues for consumers, corporations and other was net with a decrease in our voice to carriers revenues.

Revenues for consumers, corporations and other represented 11.7% of our consolidated revenues during 2005 compared to 10.8% during 2004. This increase from $5.3 million in 2004, to $5.8 million in 2005, was mainly due to the growth of our Efonica branded retail services.

Revenues for voice services sold to carriers decreased $0.6 million or 1.4% in 2005 versus 2004. During the year ended 2005, these revenues were impacted by a combination of technical difficulties associated with the migration to the new Softswitch, and the peaks and valleys of the carrier business, downward pricing pressure on average rate per minute.

Cost of Revenues

Consolidated cost of revenues increased $2.1 million or 4.9% to $45.0 million in 2005, from $42.9 million in 2004. Approximately $2.1 million of this increase was attributable to an increase in voice services to carriers.

The cost of revenues for consumers, corporations and other grew $0.1 million or 3.7% from $3.8 million in 2004 to $4.0 million in 2005, due primarily to the growth in that revenue base.

Consolidated gross margin decreased $2.3 million for 2005 over 2004. Gross margin for total voice services to carriers decreased by $2.6 million, which was partially offset by an improvement in the gross margin for consumers, corporations and other of $0.3 million.

The decline in gross margin for voice services to carriers was primarily related to a more competitive wholesale market, slightly higher network costs as a percentage of revenue, and technical difficulties associated with the migration to the Softswitch technology. The migration difficulties adversely impacted our ability to route traffic to the least cost provider, specifically for the first quarter of 2005.

Operating Expenses

Depreciation and Amortization. Depreciation and amortization decreased by $0.3 million or 16.3% to $1.5 million during the year ended 2005, from $1.8 million during 2004. Although our fixed assets increased significantly as a result of assets added during 2005, including the new Softswitch and our new retail infrastructure currently in process, our depreciation decreased as a result of many our assets being fully depreciated during all or a part of 2005.

Selling, General and Administrative. Selling, general and administrative expenses increased $1.9 million or 19.7% to $11.6 million during 2005, from $9.7 million during 2004. This increase is primarily attributed to increased salaries and benefits, as more personnel have been required to support the growth and expansion of our infrastructure. Also, increasing as a result of our growth and our becoming a public company in February 2005, have been our legal and professional fees (including expenses associated with Sarbanes Oxley), travel related expenses, occupancy costs, and insurance expense. As a percentage of revenues, selling, general and administrative expenses increased from 19.6% during 2004, to 23.6% during 2005. We believe that as we execute our business strategies, selling, general and administrative expenses as a percentage of revenues will begin to decline.

Advertising and Marketing. Advertising and marketing increased from $0.1 million in 2004 to $0.2 million in 2005, associated with the preparation of marketing materials for the launch of our new retail products and services.

Operating Loss. Our operating loss increased $4.0 million or 80.9% to a loss of $9.0 million during 2005, from a loss of $5.0 million during 2004. The increase in operating loss was primarily attributable to both the decrease in gross margin and the increase in selling, general and administrative expenses associated with infrastructure growth and public company compliance requirements.

Other Income (Expense). Total other income (expense) remained consistent at a net expense of $0.6 million during both years. During 2005, we had interest expense of $0.4 million in contrast to interest expense of $2.2 million during 2004. The $2.2 million of interest expense during 2004, included accretion of $1.7 million (in accordance with SFAS 150) related to the then outstanding Series C Preferred Stock. The $0.4 million interest expense for 2005 included only $0.3 million of accretion since all the Series C Preferred Stock was converted to common stock in connection with our February 2005 IPO. Consequently, accretion ceased and 2005 interest expense only includes accretion for the period between January 1, 2005 and February 17, 2005. In addition, interest expense was higher during 2004, as the Company had significant outstanding debt throughout all of 2004. A significant portion of this debt was repaid during February 2005 in connection with our IPO. We also had increased interest income during 2005 of $0.5 million versus $26,000 during 2004, as a result of the investment of the IPO proceeds. Gain (loss) on debt settlements changed from a net gain of $2.2 million in 2004 to a net loss of $0.1 million during 2005. The 2004 gain on debt forgiveness was attributed to $0.2 million of settlements of capital lease obligations, $0.4 million of settlement of general obligations and $1.6 million of settlements of network obligations. The loss from investment in Estel remained consistent at $0.5 million. Minority interest increased approximately $183,000 to $175,000 during the 2005 from $(7,000) during 2004. The 2005 minority interests balance is attributed to the losses incurred in connection with our Jamaica and Turkey joint ventures.

Discontinued Operations. In 2005 the Company had income of $0.2 million associated with the resolution of certain liabilities associated with previous discontinued operations.

Net Loss. The primary factors impacting our net loss for the year ended December 31, 2005, were a decrease in gross margin, an increase in selling, general and administrative expenses, and the reduction in forgiveness of debt net with a decrease in interest expense and an increase in interest income.

Liquidity and Capital Resources

Since our inception, we have incurred significant operating and net losses. In addition, we are not generating positive cash flows from operations. As of December 31, 2006, we had stockholders' equity of approximately $13.4 million in comparison to $17.7 million at December 31, 2005, and a working capital deficit of approximately $2.7 million in comparison to working capital of $7 million at December 31, 2005. The proceeds have been and will continue to be used for working capital and general corporate purposes, international deployment, and to fund the development of our retail service offerings. We may seek further financing through the sale of debt or equity securities, although we have no commitments to do so.

Below is a summary of our cash flows for the periods indicated. These cash flow results are consistent with prior years in that we continued to use significant cash in connection with our operating and investing activities and had significant cash provided by financing activities.

A summary of our cash flows for the periods indicated is as follows:

	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004(1)
Cash used in operating activities	$ (11,343,665)	$ (7,980,651)	$ (4,874,834)
Cash used in investing activities	(3,693,097)	(2,396,445)	(250,460)
Cash provided by financing activities	2,989,413	20,798,874	6,288,375
Increase (decrease) in cash and cash equivalents	(12,047,349)	10,421,778	1,163,081
Cash and cash equivalents, beginning of period	14,790,504	4,368,726	3,205,645
Cash and cash equivalents, end of period	$ 2,743,155	$ 14,790,504	$ 4,368,726

(1) These figures include an aggregate of approximately $2.2 million that was paid during the period to satisfy past obligations.

Source of Liquidity

As of December 31, 2006, we had cash and cash equivalents of approximately $2.7 million. In addition, as of December 31, 2006, we had approximately $0.8 million of cash restricted from withdrawal and held by banks as certificates of deposits securing letters of credit.

From our inception through December 31, 2006, we financed our operations from cash provided from financing activities. These activities were primarily through net proceeds of approximately $23.3 million from our IPO, and the private placement of approximately $54.6 million of equity securities, $1.6 million from the exercise of stock options and warrants, and $22.0 million from the issuance of notes. In addition, since inception we have financed the acquisition of $8.2 million of fixed assets through capital leases.

Our long-term liquidity is dependent on our ability to attain future profitable operations. We cannot predict if and when we will be able to attain future profitability.

Uses of Liquidity

Our short-term and long-term liquidity needs arise primarily from interest and principal payments related to our capital lease obligations, capital expenditures, working capital requirements as may be needed to support the growth of our business, and any additional funds that may be required for business expansion opportunities.

Our cash capital expenditures were approximately, $3.3 million during 2006, $1.9 million during 2005 and $0.6 million in 2004. We expect our cash capital expenditures to be approximately $1.0 million for the year ending December 31, 2007. The 2007 estimated capital expenditures primarily consist of the completion of our retail infrastructure buildout, purchase of additional software for expanded product offerings, and international deployment.

Cash used in operations was approximately $11.3 million during 2006, $8.0 million during 2005, and $4.9 million during 2004. The cash used in our operations has historically been a function of our net losses, gains on forgiveness of debt, and changes in working capital as a result of the timing of receipts and disbursements. Our net cash used in operating activities increased significantly during 2006, primarily attributed to the initial build-out of our retail infrastructure and the initial launch of our new products and services. As we transition our existing customers to our new infrastructure and continue to build that revenue base, we expect our net cash used in operating activities to improve during future periods.

In some situations, we may be required to guarantee payment or performance under agreements, and in these circumstances we would need to secure letters of credit or bonds to do so.

Debt Service Requirements

At December 31, 2006 we had approximately $1.2 million of current and long-term debt. This balance is current and relates to our capital leases. Our interest expense decreased significantly during 2006 compared to 2005 due to the following factor:

1. We recorded $0.3 million of accretion to interest expense related to our Series C Preferred Stock during 2005, which ceased as of February 2005 when the Series C Preferred Stock was converted to common stock. Although the accretion represented a non-cash charge to interest expense during a portion of 2005, approximately $0.7 million in cash dividends were paid during January 2005, in connection with the Series C Preferred Stock.

Capital Instruments

In December 2006, the Company completed the first phase of a private placement for the purpose of raising working capital to fund the Company's operations. The private placement provided for the issuance of a maximum of 10,000 shares of the Company's newly designated Preferred Stock, Series A-1 at $1,000 per share. The total number of shares of Preferred Stock Series A-1 issued in this private placement was 3,875 shares, for which net proceeds of approximately $3.8 million were received. In addition, the Company issued warrants to purchase 1,160,204 shares of common stock exercisable at $1.67 per share. The terms of the Series A-1 Preferred Stock will pay dividends at 8% and are convertible into Fusion's common stock at a fixed conversion price of $1.67 per share.

Summary of Contractual Obligations

As of December 31, 2006

	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years	Total
Contractual obligations:					
Debt maturing within one year	$ 150,000	$ —	$ —	$ —	$ 150,000
Capital leases	1,066,746	—	—	—	1,066,746
Operating leases	1,369,000	2,683,000	1,505,000	2,407,000	7,964,000
Minimum purchase commitments	101,574	—	—	—	101,574
Total contractual cash obligations	$ 2,687,320	$ 2,683,000	$ 1,505,000	$ 2,407,000	$ 9,282,320

Critical Accounting Policies and Estimates

We have identified the policies and significant estimation processes below as critical to our business operations and the understanding of our results of operations. The listing is not intended to be a comprehensive list. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States, with no need for management's judgment in their application. In other cases, management is required to exercise judgment in the application of accounting principles with respect to particular transactions. The impact and any associated risks related to these policies on our business operations is discussed throughout "Management's Discussion and Analysis of Financial Condition and Results of Operations" where such policies affect reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see Note 2 in the Notes to Consolidated Financial Statements for the year ended December 31, 2006, included in this Annual Report on Form 10-K. Our preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. There can be no assurance that actual results will not differ from those estimates and such differences could be significant.

Revenue Recognition - Our revenue is primarily derived from fees charged to terminate voice services over our network, retail sales to consumers and corporations through our Efonica brand, and from monthly recurring charges associated with Internet and private line services.

Variable revenue is earned based on the number of minutes during a call and is recognized upon completion of a call, adjusted for allowance for doubtful accounts receivable and billing adjustments. Revenue for each customer is calculated from information received through our network switches. Customized software has been designed to track the information from the switch and analyze the call detail records against stored detailed information about revenue rates. This software provides us the ability to do a timely and accurate analysis of revenue earned in a period. Consequently, the recorded amounts are generally accurate and the recorded amounts are unlikely to be revised in the future.

Fixed revenue is earned from monthly recurring services provided to the customer that are fixed and recurring in nature, and are contracted for over a specified period of time. The initial start of revenue recognition is after the provisioning, testing and acceptance of the service by the customer. The charges continue to bill until the expiration of the contract, or until cancellation of the service by the customer.

Additionally, the majority of our VoIP services to consumers and corporations are prepaid. The revenue received from the prepayments that is related to VoIP termination services in the current month is booked to the current month's revenue, and the remainder of the prepayments is booked to deferred revenue, until usage occurs.

Accounts Receivable - Accounts receivable are recorded net of an allowance for doubtful accounts. On a periodic basis, we evaluate our accounts receivable and record an allowance for doubtful accounts, based on our history of past write-offs and collections and current credit conditions. Specific customer accounts are written off as uncollectible if the probability of a future loss has been established and payments are not expected to be received.

Cost of Revenues and Cost of Revenues Accrual - Cost of revenues is comprised primarily of costs incurred from other domestic and international communications carriers to originate, transport and terminate calls. The majority of our cost of revenue is variable, based upon the number of minutes of use, with transmission and termination costs being the most significant expense. Call activity is tracked and analyzed with customized software that analyzes the traffic flowing through our network switches. Each period the activity is analyzed and an accrual is recorded for minutes not invoiced. This cost accrual is calculated using minutes from the system and the variable cost of revenue based upon predetermined contractual rates.

In addition to the variable cost of revenue, there are also fixed expenses. One category of fixed expenses are those associated with the network backbone connectivity to our switch facilities. These would consist of hubbing charges at our New York switch facility that allow other carriers to send traffic to our switch, satellite or cable charges to connect to our international network, or Internet connectivity charges to connect customers or vendors to Fusion's switch via the public Internet, a portion of which are variable costs. The other category of fixed expenses is associated with charges that are dedicated point-to-point connections to specific customers (both private line and Internet access).

Intangible Assets and Goodwill Impairment Testing - Absent any circumstances that warrant testing at another time, we test for goodwill and non-amortizing intangible asset impairment as part of our year-end closing process. Impairment losses are recorded when indicators of impairment are present based primarily upon estimated future cash flows.

Income Taxes - We account for income taxes in accordance with the provisions of SFAS No. 109, "Accounting for Income Taxes" ("SFAS 109"). SFAS 109 requires companies to recognize deferred tax liabilities and assets for the expected future income tax consequences of events that have been recognized in our consolidated financial statements. Deferred tax liabilities and assets are determined based on the temporary differences between the consolidated financial statements carrying amounts and the tax bases of assets and liabilities, using enacted tax rates in the years in which the temporary differences are expected to reverse. In assessing the likelihood of utilization of existing deferred tax assets and recording a full valuation allowance, we have considered historical results of operations and the current operating environment.

Recently Issued Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140," which simplifies accounting for certain hybrid financial instruments by permitting fair value re-measurement for any hybrid instrument that contains an embedded derivative that otherwise would require bifurcation and eliminates a restriction on the passive derivative instruments that a qualifying special-purpose entity may hold. SFAS No. 155 is effective for all financial instruments acquired, issued or subject to a re-measurement (new basis) event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 155 is not expected to have an impact on our results of operations or financial position.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140," which establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities by requiring that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. SFAS No. 156 is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 156 is not expected to have an impact on our results of operations or financial position.

In June 2006, the FASB issued Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN No. 48"). Fin No. 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, "Accounting of Income Taxes". The interpretation is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of this FIN will have a material impact on its financial statements.

I n September 2006, the Financial Accounting Standard Board issued "Statement of Financial Accounting Standard 157, Fair Value Measurements" ("SFAS 157") that provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year.

I n September 2006, the Securities and Exchange Commission published Staff Accounting Bulletin ("SAB") No. 108 (Topic IN), "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements". SAB No. 108 requires registrants to quantify misstatements using both the balance sheet and income statement approaches, with adjustment required if either method results in a material error. The provisions of SAB No. 108 are effective for financial statements for the first fiscal year ending after November 15, 2006. The Company is currently evaluating the effect, if any, SAB No. 108 may have on its financial statements, but it does not expect the adoption of SAB 108 to have an impact on its financial position or results of operations.

Inflation

We do not believe inflation has a significant effect on our operations at this time.

Forward Looking Statements

Certain statements contained herein may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Because such statements include risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to, risks associated with the integration of businesses following an acquisition, concentration of revenue from one source, competitors with broader product lines and greater resources, emergence into new markets, the termination of any of the Company's significant contracts or partnerships, the Company's inability to maintain working capital requirements to fund future operations or the Company's inability to attract and retain highly qualified management, technical and sales personnel.

Item 7A. Quantitative and Qualitative Disclosures About Market Risks

Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks that are inherent in our financial instruments. These instruments arise from transactions in the normal course of business.

As of December 31, 2006, the majority of our cash balances were held primarily in the form of a short-term highly liquid investment grade money market fund in a major financial institution. Due to the short-term nature of our investments, we believe that we are not subject to any material interest or market rate risks.

At December 31, 2006, all of our outstanding debt has fixed interest rates. As such, we are not subject to interest rate risk on any of our debt. As such, we currently believe that our interest rate risk is very low.

We currently do not conduct any significant amount of business in currencies other than the United States dollar. The reporting and functional currency for our Dubai international subsidiary is the United States dollar. Our other international subsidiaries currently do not have any significant operations that would provide foreign currency risk. However, in the future, we likely will conduct a larger percentage of our business in other foreign currencies that could have an adverse impact on our future results of operations.

Item 8. Consolidated Financial Statements and Supplementary Data

Our Consolidated Financial Statements required by this Item are included in Item 15 of this report on pages F-1 through F-32.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedure

(a) ***Evaluation of Disclosure Controls and Procedures***. Our principal executive officer and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Annual Report on Form 10-K, have concluded that, based on such evaluation, our disclosure controls and procedures were adequate and effective to ensure that material information relating to us, including our consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this Annual Report on Form 10-K was being prepared.

(b) ***Changes in Internal Controls***. There were no changes in our internal control over financial reporting, identified in connection with the evaluation of such internal control that occurred during our last fiscal year, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

(c) ***Limitations***. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurances that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with its policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. We periodically evaluate our internal controls and make changes to improve them.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this Item is incorporated herein by reference to the sections entitled “Management” and “Principal Stockholders” in the proxy statement for our 2007 Annual Meeting of Stockholders.

On November 1, 2004, we adopted a Corporate Code of Conduct and Ethics applicable to all employees and directors of Fusion, including our principal executive officer and principal financial and accounting officer. A copy of the Code of Conduct and Ethics is posted on our website at www.fusiontel.com. We intend to post on our website any amendments to, or waivers from, our Code of Conduct and Ethics that apply to our principal executive officer and principal financial and accounting officer.

Item 11. Executive Compensation

The information required by this Item is incorporated herein by reference to the section entitled “Executive Compensation” in the proxy statement for our 2007 Annual Meeting of Stockholders.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is incorporated herein by reference to the section entitled “Principal Stockholders” in the proxy statement for our 2007 Annual Meeting of Stockholders.

Item 13. Certain Relationships and Related Transactions

The information required by this Item is incorporated herein by reference to the section entitled “Related Party Transactions” in the proxy statement for our 2007 Annual Meeting of Stockholders.

Item 14. Principal Accounting Fees and Services

The information required by this Item is incorporated herein by reference to the section entitled “Principal Accounting Fees and Services” in the proxy statement for our 2007 Annual Meeting of Stockholders.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) Financial Statements.

The Consolidated Financial Statements filed as part of this Annual Report on Form 10-K are identified in the Index to Consolidated Financial Statements on page F-1 hereto.

(a)(2) Financial Statement Schedules.

Schedule II - Valuation and Qualifying Accounts is included on page F-32 hereto. All other financial statement schedules have been omitted because the information required to be set forth therein is not applicable or is shown on the financial statements or notes thereto.

(a)(3) Exhibits.

The following exhibits are filed herewith or are incorporated by reference to exhibits previously filed with the Securities and Exchange Commission.

Exhibit No.	Description
3.1	Certificate of Incorporation, as amended(*)
3.1	(a) Certificate of Designation of Series C Convertible Redeemable Preferred Stock(*)
3.2	Bylaws(*)
10.1	1998 Stock Option Plan(*)
10.2	Employment Agreement between registrant and Matthew Rosen(*)
10.2.1	Amended and Restated Employment Agreement between registrant and Matthew Rosen(3)
10.3	Master Service Agreement between registrant and Terremark Worldwide, Inc., dated May 29, 2003(*)
10.5	Joint Venture Agreement between registrant and Karamco, Inc., dated December 12, 2002(*)
10.6	Agreement between Fusion registrant and Communications Ventures PVT. LTD, dated May 13, 2004(*)
10.7	Form of Warrant to Purchase Common Stock(*)
10.8	Lease Agreement between registrant and SLG Graybar Sublease, LLC for the 420 Lexington Avenue, New York, NY office(*)
10.8.1	Lease Modification Agreement dated November 1, 2005, between registrant and SLG Graybar Sublease, LLC for the 420 Lexington Avenue, New York, NY office(4)
10.8.2	Lease Modification Agreement dated November 1, 2005, between registrant and SLG Graybar Sublease, LLC for the 420 Lexington Avenue, New York, NY office(4)
10.8.3	Lease Agreement dated November 1, 2005, between registrant and SLG Graybar Sublease, LLC for the 420 Lexington Avenue, New York, NY office(4)
10.9	Lease Agreement between registrant and 67 Broad Street LLC for the 75 Broad Street, New York, NY office(*)
10.10	Lease Agreement between registrant and Fort Lauderdale Crown Center, Inc. for the Fort Lauderdale, Florida office, as amended(*)
10.10.11	Amendment dated February 10, 2006, to Lease Agreement between registrant and Fort Lauderdale Crown Center, Inc., for the Fort Lauderdale, Florida office, as amended(4)
10.11	Lease Agreement between Efonica FZ- LLC and Dubai Internet City for Dubai offices(4)
10.13	Shareholders Joint Venture Agreement between registrant and Communications Ventures Index Pvt. Ltd., dated March 11, 2000(*)
10.19	Warrant to Purchase Common Stock issued by registrant to Marvin Rosen, dated July 31, 2002(*)
10.28	Non-Competition Agreement between registrant and Marvin Rosen(*)
10.29	Stock Purchase Agreement between registrant, Convergent Technologies, Ltd. And the stockholders listed on Schedule 1 Attached thereto, dated December 16, 2004, as amended and restated, dated January 11, 2005(*)
10.30	Employment Agreement between registrant and Roger Karam(*)
10.31.1	Stock Purchase Agreement between registrant, Efonica FZ-LLC and Karamco, Inc., dated January 11, 2005 and the amendment thereto(*)
10.31.2	Amendment to Stock Purchase Agreement between registrant, Efonica FZ-LLC and Karamco, Inc., dated March 24, 2006(4)
10.32	Carrier Service Agreement for International Terminating Traffic between the registrant and Qwest Communications Corporation, dated May 17, 2000(*)

Exhibit No.	Description
10.33	Carrier Service Agreement between registrant and Telco Group, Inc. dated April 3, 2001, as amended(*)
10.34	Colocation License Agreement between the registrant and Telco Group, dated January 28, 2002.(*)
10.35	International VoIP Agreement, dated April 25, 2002, as amended(*)
10.36.1	Stock Purchase Agreement dated March 8, 2005 between FUSION TURKEY, L.L.C., LDTS UZAK MESAFE TELEKOMÜNIKASYON VE .ILETIS,IM HIZMETLERI SAN.TIC.A.S. and Bayram Ali BAYRAMOGLU; Mecit BAYRAMOGLU Mehmet; Musa BAYSAN; Yahya BAYRAMOGLU and Özlem BAYSAN.(1)
10.37	Lease Agreement dated April 28, 2005, between Convergent Technologies Limited and Oceanic Digital Jamaica Limited **
10.38	Promissory Note issued by iFreedom Communications International Holdings, Limited; iFreedom Communications Corporation; iFreedom Communications (Malaysia) Sdn. Bhd.; iFreedom Communications, Inc.; iFreedom Communications Hong Kong Limited and iFreedom UK, Ltd., jointly and severally, to Registrant.(4)
10.39	Form of Subscription Agreement (5)
10.40	Form of Warrant (5)
10.41	Certificate of Designation of the Rights and Preferences of the Series A-1 Preferred Stock (5)
14	Code of Ethics of Registrant(4)
21.1	List of Subsidiaries(4)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(4)
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002(4)
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (4)
32.2	Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(4)

* Originally filed with our Registration Statement no. 33-120412 and incorporated herein by reference.

** Originally filed with our Registration Statement no. 33-120206 and incorporated herein by reference.

(1) Filed as Exhibit to our Current Report on Form 8-K filed on March 14, 2005 and incorporated herein by reference.

(2) Filed as Exhibit to or Annual Report on Form 10-K filed March 31, 2005 and incorporated herein by reference.

(3) Filed as Exhibit to our Current Report on Form 8-K filed on March 17, 2006, and incorporated herein by reference.

(4) Filed herewith.

(5) Files as Exhibit to our Current Report on Form 8-K filed on December 15, 2006, and incorporated herein by reference.

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.

Fusion Telecommunications International, Inc.

Date: April 2, 2007

By: /s/ Matthew D. Rosen

Name: Matthew D. Rosen
Title: President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, the following persons on behalf of the registrant and in the capacities and on the dates indicated have signed this report.

Name	Title	Date
/s/ Marvin S. Rosen Marvin S. Rosen	Chairman of the Board	April 2, 2007
/s/ Matthew D. Rosen Matthew D. Rosen	President and Chief Executive Officer	April 2, 2007
/s/ Barbara Hughes Barbara Hughes	Chief Financial Officer and Principal Accounting and Financial Officer	April 2, 2007
/s/ Philip Turits Philip Turits	Secretary, Treasurer, and Director	April 2, 2007
/s/ E. Alan Brumberger E. Alan Brumberger	Director	April 2, 2007
/s/ Michael Del Giudice Michael Del Giudice	Director	April 2, 2007
/s/ Julius Erving Julius Erving	Director	April 2, 2007
/s/ Evelyn Langlieb Greer Evelyn Langlieb Greer	Director	April 2, 2007
/s/ Fred P. Hochberg Fred P. Hochberg	Director	April 2, 2007
/s/ Raymond E. Mabus Raymond E. Mabus	Director	April 2, 2007
/s/ Dennis Mehiel Dennis Mehiel	Director	April 2, 2007
/s/ Paul C. O’Brien Paul C. O’Brien	Director	April 2, 2007

**FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Fusion Telecommunications International, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Fusion Telecommunications International, Inc. and Subsidiaries (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the consolidated financial statements, the Company has incurred negative cash flow from operations and net losses since inception and has limited capital to fund future operations that raise substantial doubt about their ability to continue as a going concern. Management's plans in regard to this matter are also described in Note 3. The consolidated financial statements do not include any adjustment that might result from this uncertainty.

In connection with our audits of the financial statements referred to above, we audited the financial statement schedule on page F-32. In our opinion, the financial statement schedule, when considered in relation to the consolidated financial statements taken as a whole, presents fairly, in all material respects, the information stated therein.

/s/ Rothstein, Kass & Company, P.C.

Roseland, New Jersey
March 9, 2007

FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2006	December 31, 2005
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,743,155	$ 14,790,504
Accounts receivable, net of allowance for doubtful accounts of approximately $694,000 and $414,000 in 2006 and 2005, respectively	6,743,753	2,952,760
Restricted cash	365,000	—
Prepaid expenses and other current assets	622,207	1,242,266
Assets held for sale	129,231	245,305
Total current assets	10,603,346	19,230,835
Property and equipment, net	6,422,016	4,270,966
Other assets		
Security deposits	141,868	331,891
Restricted cash	416,566	218,176
Goodwill	4,971,221	5,118,640
Intangible assets, net	4,913,360	4,861,012
Other assets	104,923	354,259
Total other assets	10,547,938	10,883,978
TOTAL ASSETS	$ 27,573,300	$ 34,385,779
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Long-term debt, current portion	$ 150,000	$ 150,000
Capital lease/equipment financing obligations, current portion	1,066,746	1,419,965
Accounts payable and accrued expenses	11,461,112	9,269,341
Investment in Estel	554,286	771,182
Liabilities of discontinued operations	95,085	620,809
Total current liabilities	13,327,229	12,231,297
Long-term liabilities		
Capital lease/equipment financing obligations, net of current portion	—	7,650
Other long-term liabilities	800,113	4,357,497
Total long-term liabilities	800,113	4,365,147
Commitments and contingencies		
Minority interests	—	67,694
Stockholders' Equity		
Preferred stock, Series A-1, $0.01 par value, 10,000 shares authorized, 3,875 and 0 shares issued and outstanding in 2006 and 2005, respectively	39	—
Common stock, $0.01 par value, 105,000,000 shares authorized, 26,971,465 and 11,114,962 shares issued and 26,958,965 and 10,439,381 shares outstanding in 2006 and 2005, respectively	269,590	104,394
Common stock, Class A, $0.01 par value, 21,000,000 shares authorized, 0 and 15,739,963 shares issued and outstanding in 2006 and 2005, respectively	—	157,400
Capital in excess of par value	114,514,725	105,447,041
Accumulated deficit	(101,338,396)	(87,987,194)
Total stockholders' equity	13,445,958	17,721,641
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 27,573,300	$ 34,385,779

See accompanying notes to consolidated financial statements.

FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31, 2006	2005	2004
Revenues	$ 47,087,064	$ 49,364,542	$ 49,557,973
Operating expenses:			
Cost of revenues, exclusive of depreciation and amortization, shown separately below	42,463,724	45,048,917	42,927,994
Depreciation and amortization	1,397,094	1,510,172	1,804,184
Loss on impairment	867,212	—	—
Selling, general and administrative expenses (includes $856,392 and $38,422 non-cash compensation for 2006 and 2005, respectively)	14,803,062	11,633,713	9,722,719
Advertising and marketing	1,335,745	175,725	81,686
Total operating expenses	60,866,837	58,368,527	54,536,583
Operating loss	(13,779,773)	(9,003,985)	(4,978,610)
Other income (expense):			
Interest income	318,333	474,109	26,428
Interest expense	(114,006)	(434,749)	(2,254,488)
Gain (loss) on settlements of debt	465,854	(75,927)	2,174,530
Loss from investment in Estel	(185,234)	(541,876)	(519,728)
Other	44,801	(195,006)	(15,965)
Minority interests	67,694	175,353	(7,654)
Total other income (expense)	597,442	(598,096)	(596,877)
Loss from continuing operations	(13,182,331)	(9,602,081)	(5,575,487)
Discontinued operations:			
Income (loss) from discontinued operations	(168,871)	207,007	545,215
Net loss	$ (13,351,202)	$ (9,395,074)	$ (5,030,272)
Losses applicable to common stockholders:			
Loss from continuing operations	$ (13,182,331)	$ (9,602,081)	$ (5,575,487)
Preferred stock dividends	—	—	(385,918)
Net loss applicable to common stockholders from continuing operations:	(13,182,331)	(9,602,081)	(5,961,405)
Income (loss) from discontinued operations	(168,871)	207,007	545,215
Net loss applicable to common stockholders	$ (13,351,202)	$ (9,395,074)	$ (5,416,190)
Basic and diluted net loss per common share:			
Loss from continuing operations	$ (0.49)	$ (0.39)	$ (0.35)
Income (loss) from discontinued operations	(0.01)	0.01	0.03
Net loss applicable to common stockholders	$ (0.50)	$ (0.38)	$ (0.32)
Weighted average shares outstanding			
Basic and diluted	26,737,083	24,965,080	16,707,114

See accompanying notes to consolidated financial statements.

FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)

	Redeemable Preferred Stock Series C	Preferred Stock Series A	Preferred Stock Series B	Preferred Stock Series A-1	Common Stock	Common Stock Class A	Capital in Excess of Par Value	Stock Dividend Distributable	Accumulated Deficit	Total
Balances, January 1, 2004	$ 3,466,538	$ 4,072	$ 735	$ —	$ 153,412	$ —	$ 62,597,546	$ 553,238	$ (73,175,930)	$ (9,866,927)
Proceeds from sales of common stock, net of investment expenses	—	—	—	—	4,299	—	1,272,771	—	—	1,277,070
Proceeds from sales of Series C Preferred Stock, net of investment expenses	4,630,626	—	—	—	—	—	—	—	—	—
Conversion of long-term debt to Series C Preferred Stock	406,740	—	—	—	—	—	—	—	—	—
Conversion of advances to Series C Preferred Stock	176,620	—	—	—	—	—	—	—	—	—
Common stock issued in settlement of accounts payable	—	—	—	—	197	—	101,873	—	—	102,070
Conversion of Series A&B Preferred Stock to common stock	—	(4,072)	(735)	—	13,735	—	(8,928)	—	—	—
Conversion of common stock to Class A Common Stock	—	—	—	—	(174,800)	174,800	—	—	—	—
Issuance of convertible debt with beneficial conversion feature	—	—	—	—	—	—	228,030	—	—	228,030
Stock dividend declared	—	—	—	—	—	—	—	385,918	(385,918)	—
Stock dividend issued	—	—	—	—	3,157	—	935,999	(939,156)	—	—
Accretion of Series C Preferred Stock	1,035,502	—	—	—	—	—	—	—	—	—
Net loss	—	—	—	—	—	—	—	—	(5,030,272)	(5,030,272)
Balances, December 31, 2004	9,716,026	—	—	—	—	174,800	65,127,291	—	(78,592,120)	(13,290,029)
Proceeds from sale of common stock, net of investment expenses	—	—	—	—	40,800	—	23,229,720	—	—	23,270,520
Conversion of convertible notes to common stock, net of debt offering costs	—	—	—	—	6,515	—	2,437,880	—	—	2,444,395
Conversion of Preferred Stock to common stock	(10,003,141)	—	—	—	31,418	—	9,971,723	—	—	10,003,141
Common stock paid for minority interest in Efonica joint venture	—	—	—	—	7,641	—	4,920,559	—	—	4,928,200
Cash difference payment related for purchase of minority interest in Efonica joint venture	—	—	—	—	—	—	(430,000)	—	—	(430,000)
Restricted stock issued for consulting services	—	—	—	—	114	—	49,886	—	—	50,000
Common stock issued for options	—	—	—	—	214	—	50,036	—	—	50,250
Class A common stock issued for warrants	—	—	—	—	—	292	84,858	—	—	85,150
Accretion of Series C Preferred Stock	287,115	—	—	—	—	—	—	—	—	—
Amortization of stock options granted to consultant	—	—	—	—	—	—	5,088	—	—	5,088
Conversion of Class A Common Stock to common stock	—	—	—	—	17,692	(17,692)	—	—	—	—
Net loss	—	—	—	—	—	—	—	—	(9,395,074)	(9,395,074)
Balances, December 31, 2005	—	—	—	—	104,394	157,400	105,447,041	—	(87,987,194)	17,721,641
Proceeds from sale of Preferred Stock, Series A-1 net of investment expenses	—	—	—	39	—	—	3,807,757	—	—	3,807,796
Conversion of Class A Common Stock to common stock	—	—	—	—	157,400	(157,400)	—	—	—	—
Exercise of warrants					143		357			500

Non-cash compensation expense - stock options	—	—	—	—	—	—	720,350	—	—	720,350
Non-cash compensation - stock issued for consulting services	—	—	—	—	375	—	99,000	—	—	99,375
Release of Efonica shares from escrow	—	—	—	—	6,756	—	4,350,742	—	—	4,357,498
Common stock issued to Xtreme VoIP Corp.	—	—	—	—	522	—	89,478	—	—	90,000
Net loss	—	—	—	—	—	—	—	—	(13,351,202)	(13,351,202)
Balances, December 31, 2006	$ —	$ —	$ —	$ 39	$ 269,590	$ —	$ 114,514,725	$ —	$ (101,338,396)	$ 13,445,958

See accompanying notes to consolidated financial statements

FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2006	**2005**	**2004**
Cash flows from operating activities			
Net loss	$ (13,351,202)	$ (9,395,074)	$ (5,030,272)
Adjustments to reconcile net loss to net cash used in operating activities:			
Loss on impairment - continuing operations	867,212	—	—
Loss on impairment - discontinued operations	216,201	—	—
Gain/loss from sale/disposal of fixed assets	(22,162)	158,525	18,421
Depreciation and amortization	1,397,094	1,510,172	1,804,184
Bad debt expense (recovery)	(15,250)	350,434	780,479
Beneficial conversion feature on convertible debt	—	—	228,030
Non-cash compensation expense	856,392	38,422	—
(Gain) loss on settlements of debt	(465,854)	75,927	(2,174,530)
Gain on discontinued operations	(140,000)	(336,910)	(556,904)
Accretion of Series C Preferred Stock	—	287,115	1,035,502
Loss from investment in Estel	185,234	541,876	519,728
Minority interests	(67,694)	(175,353)	7,654
Increase (decrease) in cash attributable to changes in operating assets and liabilities:			
Accounts receivable	(4,200,519)	96,952	(1,627,047)
Prepaid expenses and other current assets	691,226	(205,471)	(1,207,139)
Other assets	46,976	49,254	32,737
Accounts payable and accrued expenses	2,244,292	(818,149)	1,307,946
Liabilities of discontinued operations	(385,724)	(158,371)	(13,623)
Other long-term liabilities	800,113	—	—
Net cash used in operating activities	(11,343,665)	(7,980,651)	(4,874,834)
Cash flows from investing activities:			
Purchase of property and equipment	(3,299,198)	(1,877,252)	(627,219)
Proceeds from sale of property and equipment	48,217	—	36,850
Advances to Estel	(71,416)	(205,520)	(262,398)
Payments from Estel	89,285	104,102	—
Returns of security deposits	190,024	570,137	245,957
Repayments of (payments for) restricted cash	(563,390)	162,100	356,350
Payments for other intangible assets	(86,619)	—	—
Purchase of Jamaican joint ventures net of cash acquired	—	(146,486)	—
Purchase of Turkey joint venture, net of cash acquired	—	(92,971)	—
Purchase of minority interest in Efonica joint venture, net of cash acquired	—	(480,555)	—
Difference Payment related to purchase of minority interest in Efonica joint venture	—	(430,000)	—
Net cash used in investing activities	(3,693,097)	(2,396,445)	(250,460)
Cash flows from financing activities:			
Proceeds from sale of common stock and warrants, net	—	23,884,533	1,277,070
Proceeds from sale of series C Preferred Stock, net	—	—	4,630,626
Proceeds from sale of Series A-1 Preferred Stock, net	3,807,796	—	—
Proceeds from exercise of stock options	—	50,250	—
Proceeds from exercise of warrants	500	85,150	—
Repayments of escrow advances	—	—	(73,060)
Proceeds from long-term debt	—	—	1,330,000
Payments of long-term debt and capital lease/equipment financing obligations	(818,883)	(2,538,464)	(836,090)

Payment of dividends on Preferred C Stock	—	(664,634)	—
Contributions to minority stockholders of joint ventures	—	(17,961)	(40,171)
Net cash provided by financing activities	2,989,413	20,798,874	6,288,375
Net increase (decrease) in cash and cash equivalents	(12,047,349)	10,421,778	1,163,081
Cash and cash equivalents, beginning of year	14,790,504	4,368,726	3,205,645
Cash and cash equivalents, end of year	$ 2,743,155	$ 14,790,504	$ 4,368,726

See accompanying notes to consolidated financial statements.

FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS - (continued)

	Years Ended December 31,		
	2006	**2005**	**2004**
Supplemental disclosure of cash flow information:			
Cash paid during the years for interest	$ 50,303	$ 621,789	$ 302,860
Supplemental disclosure of noncash investing and financing activities:			
Acquisition of capital leases/equipment financing obligations	$ 228,800	$ 918,716	$ 760,417
Acquisition of short-term financing agreement	$ 553,888	$ —	$ —
Release of Efonica shares from escrow	$ 4,357,498	$ —	$ —
Issuance of restricted stock for consulting services	$ 99,375	$ —	$ —
Issuance of common stock for attainment of certain earn outs in Intellectual Property Transfer Agreement	$ 90,000	$ —	$ —
Liability for acquisition of Intellectual Property Transfer Agreement	$ 30,000	$ —	$ —
Conversion of accounts payable to common stock	$ —	$ —	$ 102,070
Note issued in settlement agreement	$ —	$ —	$ 150,000
Conversion of Series A and B Preferred Stock to common stock	$ —	$ —	$ 13,735
Conversion of convertible notes payable and related debt offering costs	$ —	$ 2,444,395	$ —
Conversion of Series C Preferred Stock to common stock	$ —	$ 10,003,141	$ —
Conversion of prepaid offering costs to additional paid in capital	$ —	$ 614,008	$ —
Conversion of long-term debt to Series C Preferred Stock	$ —	$ —	$ 406,740
Conversion of escrow advances to Series C Preferred Stock	$ —	$ —	$ 176,620
Conversion of interest payable to debt	$ —	$ —	$ 108,333
Stock dividends issued	$ —	$ —	$ 939,156
Stock dividends declared	$ —	$ —	$ 385,918
Supplemental disclosure of joint venture acquisition activities:			
Fair value of tangible assets, net of cash acquired	$ —	$ 654,791	$ —
Fair value of identifiable intangible assets	—	4,877,900	—
Efonica Difference Payment	—	430,000	—
Goodwill acquired	—	5,118,640	—
Liabilities acquired	—	(401,504)	—
Minority interest acquired	—	(244,118)	—
Common stock issued or to be issued	—	(9,285,697)	—
Cash paid for acquisition of joint ventures, net of cash acquired	$ —	$ 1,150,012	$ —

See accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations

Fusion Telecommunications International, Inc. and Subsidiaries (collectively the "Company") is a Delaware corporation, incorporated in September 1997. The Company is an international communications carrier delivering Voice over Internet Protocol ("VoIP") and other Internet services to, from, in and between emerging markets in Asia, the Middle East, Africa, Latin America, and the Caribbean. The Company currently provides a full suite of communications services to corporations, consumers, communication carriers, Internet service providers and government entities.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Fusion Telecommunications International, Inc. and its wholly owned and majority owned subsidiaries. All material inter-company accounts and transactions have been eliminated in consolidation.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of a sales arrangement exists, delivery has occurred or services have been rendered, the sales price is fixed and determinable and collectibility is reasonably assured. When significant, the Company records provisions against revenue for billing adjustments, which are based upon estimates derived from factors that include, but are not limited to, historical results, analysis of credits issued, current economic trends and changes in demand. The provisions for revenue adjustments are recorded as a reduction of revenue when incurred or ratably over a contract period, as applicable.

The Company derives revenue principally from international voice, including VoIP, private networks and Internet services. Variable revenue derived from international voice services is recognized upon completion of a call and is based upon the number of minutes of traffic carried. Revenue from monthly recurring service from long distance, private networks and Internet services are fixed and recurring in nature and are contracted over a specific period of time. Advanced billings for monthly fees are reflected as deferred revenues and are recognized as revenue at the time the service is provided. VoIP services enable customers, typically international corporations or cable operators, to place voice calls anywhere in the world using their personal computer. The majority of the Company's VoIP services to consumers are prepaid which is initially recorded as deferred revenue. Revenues from VoIP services to consumers are recognized based upon the usage of minutes by the consumer.

Cash and Cash Equivalents

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

Accounts Receivable

The Company values its accounts receivable net of an allowance for doubtful accounts. On a periodic basis, the Company evaluates its accounts receivable and establishes an allowance for doubtful accounts, based on a history of past write-offs and collections and current credit conditions. Specific customer accounts are written off as uncollectible if the probability of a future loss has been established and payments are not expected to be received.

2. Summary of Significant Accounting Policies - (continued)

Fair Value of Financial Instruments

The fair value of the Company's assets and liabilities, which qualify as financial instruments under Statement of Financial Accounting Standards ("SFAS") No. 107, "Disclosures About Fair Value of Financial Instruments," approximate the carrying amounts presented in the accompanying Consolidated Balance Sheets.

Goodwill and other Intangible Assets

Goodwill represents the excess of the purchase price of an acquired business over the amounts assigned to assets acquired and liabilities assumed. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill is not being amortized but is reviewed for impairment on an annual basis. Other intangible assets consist primarily of the trade name and trademarks associated with the Company's wholly-owned subsidiary, Efonica FZ, LLC ("Efonica"). These long-lived assets are not amortized because they have indefinite lives. The remaining intangible asset acquired in the Efonica transaction is a customer list, which is being amortized using the straight-line method over the 10 year estimated useful life.

Impairment of Long-Lived Assets and Impairment Charges

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", long-lived assets, including intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. If an impairment indicator is present, the Company evaluates recoverability by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If the assets are impaired, the impairment recognized is measured by the amount by which the carrying amount exceeds the estimated fair value of the assets.

In December 2006, the Company recorded $867,212 which consisted of $590,559 of impairment against retail infrastructure equipment, as well as $276,653 of impairment of assets associated with the joint venture in Jamaica. In February of 2006, an asset that had been previously impaired during 2003 was sold, and the Company received proceeds of $45,000, which was the net realizable value that remained on the books. Additionally, the Company also received proceeds of $3,217 for miscellaneous office equipment sold during the year ended December 31, 2006.

Property and Equipment

Property and equipment are stated at cost and are depreciated or amortized on the straight-line method over the estimated useful lives of the assets as follows:

Asset	Estimated Useful Lives
Network equipment	5-7 Years
Furniture and fixtures	3-7 Years
Computer equipment and software	3-5 Years
Leasehold improvements	Lease terms

Maintenance and repairs are charged to operations, while betterments and improvements are capitalized.

2. Summary of Significant Accounting Policies - (continued)

Advertising and Marketing

Advertising and marketing costs primarily relate to the Company's on-line Efonica advertising campaign. In connection with this campaign, the costs of production are expensed as incurred. The costs of communicating this advertising are expensed when received by the on-line consumer (i.e., consumer receives a link to the Efonica website as a result of a search engine keyword search). The Company's costs also include newspaper ads for its Efonica retail services, product press releases, public relations and customer relations fees, and exhibitions the Company attends to promote these retail services.

Income Taxes

The Company complies with SFAS No. 109, "Accounting for Income Taxes," which requires an asset and liability approach to financial reporting for income taxes. Deferred income tax assets and liabilities are computed for differences between the financial statement and tax bases of assets and liabilities that will result in future taxable or deductible amounts, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amount expected to be realized.

Foreign Currency Conversion

The Company's subsidiaries enter into foreign currency transactions. Conversion gains or losses resulting from these foreign currency transactions are included in the accompanying Consolidated Statements of Operations.

Comprehensive Income

The Company complies with SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes rules for the reporting and display of comprehensive income and its components. Comprehensive loss was equal to the net loss amounts presented for the respective periods in the accompanying Consolidated Statements of Operations.

Earnings Per Share

SFAS No. 128, "Earnings Per Share," requires dual presentation of basic and diluted income per share for all periods presented. Basic income per share excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the income of the Company.

Unexercised stock options to purchase 2,832,546, 2,100,798 and 1,848,792 shares of the Company's common stock as of December 31, 2006, 2005 and 2004, respectively, were not included in the computation of diluted earnings per share because the exercise of the stock options would be anti-dilutive to earnings per share.

Unexercised warrants to purchase 8,588,709, 7,462,435, and 286,578 shares of the Company's common stock as of December 31, 2006, 2005 and 2004, respectively, were not included in the computation of diluted earnings per share because the exercise of the warrants would be anti-dilutive to earnings per share.

Non-converted debt to purchase 97,998 shares of the Company's common stock as of December 31, 2004, was not included in the computation of diluted earnings per share because the conversion of the debt would be anti-dilutive to earnings per share. Had the debt been converted, interest expense would have been reduced by approximately $49,000 during the year ended December 31, 2004.

2. Summary of Significant Accounting Policies - (continued)

Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"), that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for either equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R eliminates the ability to account for share-based compensation transactions, as the Company formerly did, using the intrinsic value method as prescribed by Accounting Principles Board ("APB"), Opinion No. 25, "Accounting for Stock Issued to Employees," and generally requires that such transactions be accounted for using a fair-value-based method and recognized as an expense in the Company's Consolidated Statements of Operations.

The Company adopted SFAS No. 123R using the modified prospective method, which required the application of the accounting standard as of January 1, 2006. The Company's consolidated financial statements for the year ended December 31, 2006, reflect the impact of adopting SFAS No. 123R. In accordance with the modified prospective method, the consolidated financial statements for prior years have not been restated to reflect, and do not include, the impact of SFAS No. 123R.

Stock-Based compensation expense recognized during the year is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. Stock-based compensation expense recognized in the Consolidated Statements of Operations during the year ended December 31, 2006, includes compensation expense for stock-based payment awards granted prior to, but not yet vested, as of December 31, 2005, based on the grant date fair value estimated in accordance with SFAS No. 123R. As stock-based compensation expense recognized in the Consolidated Statement of Operations for the year ended December 31, 2006, is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. When estimating forfeitures, the Company considered termination behaviors as well as trends for actual option forfeiture. In the pro forma information required under SFAS No. 148 ("Accounting for Stock-Based Compensation - Transition and disclosure - an amendment of FASB Statement No. 123") for the periods prior to 2006, the Company accounted for forfeitures as they occurred.

The Company has recognized compensation expense based on the estimated grant date fair value method using the Black-Scholes valuation method. The impact on the Company's results of operations of recording stock-based compensation for the year ended December 31, 2006, was an expense of $720,350, which is included in selling, general and administrative expenses in the Consolidated Statements of Operations.

The following table illustrates the effect on the net loss and loss per share as if the Company had applied the fair value recognition provisions of SFAS No. 123R for the years ended December 31, 2005 and 2004.

	2005	2004
Net loss applicable to common stockholders, as reported	$ (9,395,074)	$ (5,416,190)
Deduct: total stock-based compensation expense under fair value method for awards, net of related tax effect	(2,152,765)	(771,852)
Net loss applicable to common stockholders, pro forma	$(11,547,839)	$ (6,188,042)
Earnings per share:		
Basic and diluted net loss applicable to common stockholders, as reported	$ (0.38)	$ (0.32)
Basic and diluted net loss applicable to common stockholders, pro forma	$ (0.46)	$ (0.37)

2. Summary of Significant Accounting Policies - (continued)

Stock-Based Compensation - (Continued)

The Company calculated the fair value of each common stock option grant on the date of grant using the Black-Scholes option pricing model method with the following assumptions:

	2006	2005	2004
Dividend yield	0.0%	0.0%	0.0%
Average risk free interest rate	4.94%	4.26%	4.50%
Average option term	4.0	4.0	4.0
Stock volatility	76.99%	82.0%	0.0%

Recently Issued Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140," which simplifies accounting for certain hybrid financial instruments by permitting fair value re-measurement for any hybrid instrument that contains an embedded derivative that otherwise would require bifurcation and eliminates a restriction on the passive derivative instruments that a qualifying special-purpose entity may hold. SFAS No. 155 is effective for all financial instruments acquired, issued or subject to a re-measurement (new basis) event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 155 is not expected to have an impact on the Company's results of operations or financial position.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140," which establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities by requiring that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. SFAS No. 156 is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 156 is not expected to have an impact on the Company's results of operations or financial position.

In June 2006, the FASB issued Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN No. 48"). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." The interpretation is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of this FIN will have a material impact on its financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB No. 108"). SAB No. 108 clarifies the SEC staff's beliefs regarding the process of quantifying financial statement misstatements and is effective for fiscal years ending after November 15, 2006. The Company does not expect SAB No. 108 to have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157 "Fair Value Measurements", which establishes a framework for measuring fair value and requires expended disclosure about the information used to measure fair value. The statement applies whenever other statements require, or permit, assets or liabilities to be used to measure fair value. The statement does not expand the use of fair value in any new circumstances and is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption encouraged. The Company does not expect the adoption of this statement to have a material impact on its financial condition or results of operations.

2. Summary of Significant Accounting Policies - (continued)

Use of Estimates

The preparation of the consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to the 2005 and 2004 consolidated financials statements to conform to the 2006 presentation.

3. Going Concern

At December 31, 2006, the Company had a working capital deficit of approximately $2,724,000 and an accumulated deficit of approximately $101,338,000. The Company has continued to sustain losses from operations, and for the years ended December 31, 2006, 2005 and 2004 has incurred a net loss of approximately $13,351,000, $9,395,000 and $5,030,000, respectively. In addition, the Company has not generated positive cash flow from operations since inception. The Company is reviewing options to raise additional capital through debt and/or equity financing. Management is aware that its current cash resources are not adequate to fund its operations for the remainder of the year and the company's long-term liquidity is dependent on its ability to successfully complete the rollout of its full suite of certain VoIP paid services and effectively market its paid services, in order to attain profitable operations in the future. The Company cannot make any guarantees if and when it will be able to attain profitability. These conditions, among others, raise substantial doubt about the Company's ability to continue as a going concern. No adjustment has been made in the consolidated financial statements to the amounts and classification of assets and liabilities, which could result, should the Company be unable to continue as a going concern.

4. Joint Ventures, Acquisitions and Divestitures

Estel

In March 2000, the Company entered into a joint venture agreement with Communications Ventures India Pvt. Ltd. to form an entity named Estel Communication Pvt. Ltd. ("Estel"). Estel is organized and exists under the laws of India and has its office in New Delhi, India. The Company directly owns 49% of the joint venture and has voting rights in another 1.01%, which in turn gives the Company a 50.01% voting control in the joint venture. Estel was established to engage in the business of selling and supporting Internet service protocol operations. Basically, Estel is in business as an Internet & VoIP service provider in India. The joint venture has been funded primarily by the Company, which has also provided certain equipment for the establishment of the required technology platforms.

Efonica

In December 2002, the Company acquired a 50.2% equity interest in a joint venture with Karamco, Inc. to provide various VoIP services throughout the emerging markets. Operations of the joint venture began during 2003.

During February 2005, the Company closed on its agreement to acquire the remaining 49.8% minority interest in Efonica from Karamco, Inc. This acquisition was completed to better enable Efonica to serve as the retail VoIP services division of Fusion, offering a full suite of VoIP solutions to customers in Asia, the Middle East, Africa, Latin America and the Caribbean. With 100% control, the Company can better leverage the significant experience and relationships of Efonica. The operating results for the 49.8% minority interest acquired are included in the Consolidated Statement of Operations from the date of acquisition.

Under its original terms, the purchase price ranged between a minimum of $5.4 million and a maximum of $14.3 million. At closing, Karamco, Inc. received cash of $500,000 and shares equal to the Base Purchase Price determined by the initial price of common stock at the date of the Company's IPO. The Base Purchase Price was equal to 49.8% of the initial estimated valuation of Karamco Inc or approximately $9.8 million. At the date of the IPO, approximately 1.44 million of shares were issued under this agreement of which Karamco received approximately 765,000 of shares and approximately 676,000 shares were held in escrow. During 2005, approval was given to release the shares being held in escrow. Consequently, the value of these shares of approximately $4.4 million was reflected as goodwill and as a long-term liability in the December 31, 2005 Consolidated Balance sheet. In March 2006, under an amendment to the Efonica Purchase Agreement, the escrowed shares were released to Karamco, subject to a lock-up period until February 15, 2007. During 2006, the Company released approximately 676,000 shares in escrow, which resulted in an increase of stockholders equity of approximately $4.4 million and a reduction to the long-term liability (see Note 17).

Out of the shares issued to Karamco, the Company agreed to register for resale 150,000 shares of common stock in a registration statement. Karamco was restricted from selling in excess of $1 million worth of common stock during the one-year period following the IPO Prospectus Date. If the sale of the 150,000 shares registered resulted in less than $1 million of gross proceeds, the Company is required to pay Karamco the difference between the aggregate gross proceeds of Karamco's sale of the registered shares and $1 million (the "Difference Payment"). At December 31, 2005, the Company has paid Karamco $430,000 towards the Difference Payment which is reflected as capital in excess of par value in the accompanying Consolidated Balance Sheet. In the event the Difference Payment is less than $430,000, Karamco is obligated to reimburse the Company for such excess. This obligation is secured by 50,387 shares held in escrow. The time period for the Difference Payment, under the March 2006 amendment to the purchase agreement was extended to March 2007.

4. Joint Ventures, Acquisitions and Divestitures - (continued)

Jamaica

In December 2004, the Company concluded an agreement to acquire 51% of the common stock of a Jamaican telecommunications company in exchange for $150,000. The company currently holds international and domestic carrier license agreements with the Jamaican government, which enable it to operate as an international carrier through 2013 and as a domestic carrier through 2018.

In October 2006, the Company received an offer to purchase certain assets and liabilities of the holdings in Jamaica. The contract associated with that offer was subsequently defaulted on, and the Company will vigorously pursue legal action associated with this default. Although the Company intends to do business in Jamaica in the future, the Company has reviewed the assets associated with that subsidiary, and as a result of the changes in the Company's business plan, the Company has impaired approximately $277,000 associated with the assets of this entity during the year ended December 31, 2006.

Turkey

On March 8, 2005, a new wholly owned subsidiary of the Company, Fusion Turkey, LLC entered into a Stock Purchase Agreement to acquire 75% of the shares of LDTS Uzak Mesafe Telekomikasyon ve Iletism Hizmetleri San. Tic. A.S. ("LDTS"), from the existing shareholders. LDTS possesses a telecommunications license approved by the Turkish Telecom Authority.

During the fourth quarter of 2006, the Company decided to either sell, or wind down and liquidate its Turkey joint venture. This decision was a result of various challenges the Company encountered from an increasingly complicated and constantly changing regulatory in Turkey, which made it very difficult to enter the market. These regulatory difficulties included an unstable environment as well as the selling of Turk-Telecom, which was a government owned entity, to a private company. As a result of this decision, certain assets of this subsidiary were considered impaired and the operations of this subsidiary are being treated as a discontinued operation. See Note 8 for further discussion.

All joint ventures identified above, excluding Estel, have been accounted for under the consolidation method of accounting as the Company maintained a majority equity ownership in the aforementioned joint ventures.

Since the Company maintains operations in foreign countries through its joint ventures, the Company may be subject to exchange control regulations or other impediments to convert foreign currencies into U.S. dollars. In addition, the Company may generate earnings, which may be unable to be repatriated outside the country in which they are earned. As of December 31, 2006, the Company's joint ventures have not generated profits that would be subject to such restrictions.

5. Investment in Estel

As of December 31, 2006 and 2005, the loss in excess of investment in Estel of approximately $554,000 and $771,000, respectively, represents the Company's 49% investment in Estel (See Note 4 for further discussion). Loss from investment in Estel was approximately $(185,000), $(542,000), and $(520,000) for the years ended December 31, 2006, 2005 and 2004, respectively. Summarized financial data of Estel is below.

	Years Ended December 31,	
	2006	2005
Current assets	$ 325,000	$ 449,000
Non-current assets	$ 336,000	$ 546,000
Current liabilities	$ 1,541,000	$ 1,684,000
Total stockholders' equity (deficit)	$ (880,000)	$ (689,000)

	Years Ended December 31,		
	2006	2005	2004
Net revenues	$ 1,715,000	$ 2,191,000	$ 2,280,000
Net loss	$ (185,000)	$ (542,000)	$ (520,000)

The investment by the other shareholder of Estel was fully absorbed by its pro rata share of losses during 2001. The Company has continued to fund 100% of Estel's operations and as a result, the Company has recorded 100% of Estel's losses for the years ended December 31, 2006, 2005 and 2004 as loss from investment in Estel.

For the years ended December 31, 2006, 2005, and 2004, revenues included approximately $71,416, $201,000, and $321,000, respectively, for VoIP and IP services provided to Estel. At December 31, 2006 and 2005, the amounts due from this joint venture were approximately $431,000 and $29,000, which is net of $414,000 and $834,000 allowance, respectively. These receivables are non-interest bearing, due on demand, and are included in Investment in Estel on the accompanying balance sheets.

In considering, EITF No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights", management has evaluated the facts and circumstances underlying each joint venture relationship such as the financial dependence of the minority shareholders on the Company and corporate governance of each joint venture. Based upon these facts and circumstances, the Company has determined that the minority shareholder of Estel has substantive rights that prohibit the consolidation of this joint venture. As a result, the Company has accounted for this joint venture under the equity method of accounting.

6. Goodwill and Identifiable Intangible Assets

The Company's goodwill relates primarily to the VoIP to Consumers and Corporations reporting segment. The changes in the amount of goodwill for the years ended December 31, 2006 and 2005, are as follows:

	Year ended December 31	
	2006	2005
Beginning balance	$ 5,118,640	$ —
Goodwill for Jamaican acquisition	—	147,419
Goodwill for purchase of Efonica minority interest	—	4,971,221
Impairment of Jamaican acquisition goodwill	(147,419)	—
Ending balance	$ 4,971,221	$ 5,118,640

Identifiable intangible assets, net, as of December 31, 2006, are composed of:

Trademarks	$ 4,588,541
Customer list, net of accumulated amortization of $52,300	246,500
Intellectual property	78,319
	$ 4,913,360

These identifiable intangible assets were acquired in connection with the Company's purchase of the 49.8% minority interest in its Efonica joint venture. The trademarks are not subject to amortization as they have an indefinite life. Amortization on the customer list during the year ended December 31, 2006 and 2005, was $29,880 and $22,420, respectively. There was no customer list amortization during 2004. The following table presents estimated amortization expense for each of the succeeding calendar years.

2007	$ 29,880
2008	29,880
2009	29,880
2010	29,880
2011	29,880
Thereafter	97,100
	$ 246,500

7. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following at December 31, 2006 and 2005.

	2006	2005
Prepaid Expense	$ 440,028	$ 531,715
Inventory	67,418	63,655
Note receivables	47,313	2,535
Other	67,448	644,361
Total	$ 622,207	$ 1,242,266

8. Discontinued Operations

As discussed in Note 4, the Company decided in the quarter ended September 30, 2006, to dissolve its subsidiary in Turkey. The dissolution and liquidation, or a sale of the entity, should be completed during the first half of 2007. In accordance with SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”, the Company has classified the operating results of its Turkey joint venture as a discontinued operation in the accompanying Consolidated Financial Statements. The December 31, 2006 and 2005 financial statements have been adjusted for these discontinued operations. These discontinued operations affect only the Company’s corporate and unallocated segment. The following is a summary of the operating results of the discontinued operations.

	2006	2005	2004
Gain on settlement of domestic retail telecommunications business liabilities	$ 140,000	$ 336,910	$ 545,215
Depreciation and amortization	(1,049)	—	—
Loss on impairment	(216,201)	—	—
Selling, general and administrative expenses	(61,794)	(120,649)	—
Advertising and marketing	—	(8,914)	—
Other	(29,827)	(340)	—
Income (loss) from discontinued operations	$ (168,871)	$ 207,007	$ 545,215

Prior to 2006, the Company’s discontinued operations related to Management’s decision in 2001 to cease the operations of its domestic retail telecommunication services business lines. The Company continues its efforts to settle certain of these remaining liabilities. As a result of these efforts, the Company recognized gains of $140,000, $336,910 and $545,215 during the years ended December 31, 2006, 2005 and 2004, respectively. The remaining liability at December 31, 2006 and 2005 of approximately $95,000 and $621,000, respectively, is related to trade payables and accrued expenses associated with the discontinued retail telecommunications services. During the year ended December 31, 2006, the Company paid approximately $386,000 of these outstanding liabilities.

9. Property and Equipment

At December 31, 2006 and 2005, property and equipment is comprised of the following:

	2006	2005
Network equipment, including $804,710 and $1,055,828 under capital and equipment financing leases in 2006 and 2005, respectively	$ 8,236,466	$ 6,970,002
Furniture and fixtures	372,431	120,377
Computer equipment and software, including $0 and $52,826 under capital and equipment financing leases in 2006 and 2005, respectively	1,772,267	968,525
Leasehold improvements	3,339,128	2,710,219
Assets in progress, including $0 and $318,262 under capital and equipment financing leases in 2006 and 2005, respectively	542,377	1,445,167
	14,262,669	12,214,290
Less accumulated depreciation and amortization, including $160,942 and $96,110 under capital and equipment financing leases in 2006 and 2005, respectively	(7,840,653)	(7,943,324)
	$ 6,422,016	$ 4,270,966

10. Restricted Cash

During July 2006, in connection with the Company's 75% owned subsidiary in Turkey, the Company provided a Letter of Credit for 250,000 Euros (approximately $325,000) to the Telekomunikasyon Kurumu Telecommunication Administrator. This Letter of Credit is to secure a license to do business as a long distance telecommunication services company in Turkey. The guarantee was effective until January 1, 2007. Since the Company has since discontinued these operations in Turkey (See Note 4), at December 31, 2006, it was in the process of requesting authorization to cancel this Letter of Credit and secure the return of the funds. This letter of credit was cancelled and the funds were received during February 2007.

As of December 31, 2006 and 2005, the Company had approximately $782,000 and $218,000, respectively, of cash restricted from withdrawal and held by banks as certificates of deposit securing letters of credit. This restricted cash is required as security deposits for certain of the Company's non-cancelable operating leases for office facilities and to secure a license to do business in Turkey. The letter of credit related to the Turkey business license, which amounted to $325,000 was cancelled in January 2007 and the full amount was received back in February 2007.

11. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of the following at December 31, 2006 and 2005:

	2006	2005
Trade accounts payable	$ 8,778,068	$ 6,134,373
Accrued expenses	1,713,482	1,892,216
Interest payable	398,768	334,869
Deferred revenue	239,511	810,837
Short-term financing agreement	172,863	—
Other	158,420	97,046
	$ 11,461,112	$ 9,269,341

The deferred revenue balance at December 31, 2005, included approximately $466,000 related to a debt settlement agreement with a domestic carrier. The provisions of the agreement provided that $555,000 due to the carrier would be resolved with a service agreement whereby the carrier will receive a reduced rate for certain minutes of traffic that is passed through the Company's network through December 2005. The Company and the carrier continued to comply with the terms of this agreement until it was settled in June 2006, at which point the remaining deferred revenue balance of $466,000 was recorded as a gain on settlement of debt (see Note 18). During the years ended December 31, 2005 and 2004, approximately $4,000 and $86,000, respectively, of revenue were recognized in connection with this service agreement.

12. Long-Term Debt and Capital Lease/Equipment Financing Obligations

At December 31, 2006 and 2005, components of long-term debt and capital lease/equipment financing obligations of the Company are comprised of the following:

	2006	2005
Promissory notes payable(a)	$ 150,000	$ 150,000
Capital lease/equipment financing obligations(b)	1,066,746	1,427,615
Total long-term debt and capital lease/equipment financing obligations	1,216,746	1,577,615
Less current portion	(1,216,746)	(1,569,965)
	$ —	$ 7,650

(a) During February 2004, the Company entered into a settlement agreement for $600,000. In the same month, the Company paid $450,000 and agreed to make 12 monthly payments for the remaining $150,000. The debt has not been repaid as of December 31, 2006, as the other party to the settlement agreement has not complied with the terms of the agreement.

(b) The Company entered into several financing agreements for equipment purchases during 2005 and prior. The Company has imputed an interest rate of 10.0% related to these agreements, which are payable every 90 days over a 12-18 month period. During 2006, the Company entered into a lease agreement of $279,136 to purchase software for $228,800 and support for $50,336. The interest rate is 7.3% and payments are due every 90 days over a 16-month period. During 2006, the Company entered into a short-term financing agreement for $553,888 to purchase certain hardware, software, and software support from an equipment vendor. The payments are due on a monthly basis over a 9-month period. The vendor is charging a 7% finance charge for the $241,000 hardware portion of the purchase. During December 31, 2004, approximately $193,000 of capital lease/equipment financing obligations had been forgiven and recorded to forgiveness of debt (see Note 18 for further discussion). At December 31, 2006 and 2005, approximately $720,000 of the capital lease obligations were in default and accordingly have been classified as currently due.

Future aggregate principal payments on long-term debt and capital lease/equipment financing obligations in the years subsequent to December 31, 2006, are as follows:

Year Ending December 31, 2007	$ 1,618,522
Total minimum payments	1,618,522
Less amount representing interest	(401,776)
Present value of minimum payments	1,216,746
Less current portion	(1,216,746)
	$ —

13. Income Taxes

Due to the operating losses incurred, the Company has no current income tax provision for the years ended December 31, 2006, 2005 and 2004. The provision for income taxes consists of the following:

	2006	2005	2004
Deferred			
Federal	$ (3,989,000)	$ 2,883,000	$ (1,662,000)
State	105,000	(277,000)	(56,000)
	(3,884,000)	2,606,000	(1,718,000)
Change in valuation allowance	3,884,000	(2,606,000)	1,718,000
	$ —	$ —	$ —

The following reconciles the Federal statutory tax rate to the effective income tax rate:

	2006	2005	2004
	%	%	%
Federal statutory rate	34.0	34.0	34.0
State, net of federal tax	0.8	2.9	1.1
Other	0.2	(1.9)	(0.1)
Change in valuation allowance	(35.0)	(35.0)	(35.0)
Effective income tax rate	—	—	—

The components of the Company's deferred tax assets and liability consist of approximately the following at December 31, 2006 and 2005, respectively:

	2006	2005
Deferred tax assets		
Net operating losses	$ 25,047,000	$ 20,463,000
Allowance for doubtful accounts	443,000	499,000
Accrued liabilities and other	167,000	534,000
Property and equipment	1,303,000	1,580,000
	26,960,000	23,076,000
Deferred tax liability		
Property and equipment	—	—
Deferred tax asset, net	26,960,000	23,076,000
Less valuation allowance	(26,960,000)	(23,076,000)
	$ —	$ —

The Company has available at December 31, 2006 and 2005, approximately $73,667,000 and $60,184,000, respectively, of unused net operating loss carry forwards that may be applied against future taxable income, which expire in various years from 2012 to 2025. Under the Tax Reform Act of 1986, the amounts of and benefits from net operating loss carry forwards and credits may be impaired or limited in certain circumstances. Events which cause limitations in the amount of net operating losses that the Company may utilize in any one year include, but are not limited to, a cumulative ownership change of more than 50%, as defined, over a three year period. The amount of such limitation, if any, has not been determined.

Management of the Company had decided to fully reserve for its net deferred tax assets, as it is more likely than not that the Company will not be able to utilize these deferred tax assets against future taxable income, coupled with certain limitations on the utilization of the net operating losses due to various changes in ownership over the past several years.

14. Commitments and Contingencies

The Company has various non-cancelable operating lease agreements for office facilities. A summary of the lease commitments under non-cancelable leases at December 31, 2006, is approximately as follows:

Year Ending December 31,

2007	$1,333,111
2008	1,283,392
2009	1,316,391
2010	826,793
2011	658,546
Thereafter	2,406,970
	$7,825,203

Rent expense for all operating leases was approximately $1,538,000, $1,309,000, and $1,145,000 for the years ended December 31, 2006, 2005 and 2004, respectively. Certain of the Company's leases include fixed rent escalation schedules or rent escalations based upon a fixed percentage. The Company recognizes rent expense (including escalations) on a straight-line basis over the lease term.

The Company has relocated its New York executive offices and expanded its Fort Lauderdale office during 2006. The revised lease terms for both of these offices are reflected in the above lease commitment schedule.

As of December 31, 2006, the Company has outstanding purchase commitments of approximately $102,000.

Legal Matters

On May 28, 2003, Jack Grynberg, et al., an investor in one of the Company's private offerings, filed a complaint with the Denver District Court, State of Colorado (*Jack Grynberg, et al v. Fusion Telecommunications International, Inc., et al*, 03-CV-3912) seeking damages in the amount of $400,000 for the purchase of an interest in Fusion's 1999 private placement offering of subordinated convertible notes through Joseph Stevens & Company, Inc., a registered broker dealer. This complaint asserted the following claims for relief against the Company: Breach of Fiduciary Duty, Civil Theft, Deceptive Trade Practices, Negligent Misrepresentation, Deceit Based on Fraud, Conversion, Exemplary Damages and Prejudgment Interest. On June 25, 2004, the Company filed with the Court a Motion to Dismiss, which was granted. The Company was awarded attorneys' fees by the court. A written order of Judgment in favor of the Company and against the plaintiff in the amount of approximately $40,000 was recorded on January 24, 2006. The plaintiffs have filed an appeal of the motion, which is still pending as of the date of this filing.

On March 30, 2006, an equipment vendor filed a complaint with the Circuit Court in Broward County, State of Florida seeking damages in the amount of approximately $1,380,000 allegedly due on two promissory notes plus accrued interest through March 1, 2006 and attorney costs. Management asserted a counterclaim against the vendor which was settled subsequent to year end resulting in the amendment of an existing contract with the vendor. The Company's legal counsel has advised that, at this stage, they cannot accurately predict the likelihood of an unfavorable outcome or quantify the amount or range of potential loss, if any. Accordingly, with the exception of amounts previously accrued by the Company under the capital lease arrangement, no adjustment that may result from resolution of these uncertainties has been made in the accompanying financial statements.

The Company is currently undergoing an audit by New York State for franchise and excise taxes, which has not yet been concluded and may result in an indeterminate amount of tax liability, not previously accrued for.

14. Commitments and Contingencies (continued)

The Company is involved in other claims and legal actions arising in the normal course of business. Management does not expect that the outcome of these cases will have a material effect of the Company's financial position.

Due to the regulatory nature of the industry, the Company is periodically involved in various correspondence and inquiries from state and federal regulatory agencies. Management does not expect the outcome on these inquiries to have a material impact on the Company's operations or financial condition.

15. Preferred Stock

As of December 31, 2006, the Company has authorized 10,000,000 shares of its stock for the issuance of Preferred Stock. The Company has designated 1,100,000, 1,500,000 and 110,000 shares of $10 Series A Convertible Redeemable Preferred Stock ("Series A Preferred Stock"), $10 Series B Convertible Redeemable Preferred Stock ("Series B Preferred Stock") and $90 Series C Convertible Redeemable Preferred Stock ("Series C Preferred Stock"). In addition, during December 2006, the Company designated 10,000 shares of Series A-1 Cumulative Convertible Preferred Stock.

In December 2006, the Company completed the first phase of a private placement for the purpose of raising working capital for the Company's operations. The private placement provided for the issuance of a maximum of 10,000 shares of the Company's newly designated Preferred Stock, Series A-1 at $1,000 per share. The total number of shares of Preferred Stock Series A-1 issued in this private placement was 3,875 shares, for which approximately $3.8 million were received, net of expenses of approximately $67,000 and are being used for working capital. In addition, the Company issued warrants to purchase 1,160,204 shares of common stock exercisable at $1.67 per share. The terms of the Series A-1 Preferred Stock will pay dividends at 8% and are convertible into Fusion's common stock at a fixed conversion price of $1.67 per share.

During May 2004, each outstanding share of Series A and Series B Preferred Stock was converted to common stock at a conversion rate of $3.50 per share. Consequently as of December 31, 2004, there were no shares outstanding of Series A and Series B Preferred Stock.

At December 31, 2004, there were 109,962 shares of the Series C Preferred Stock outstanding. The holders of the Series C Preferred Stock were entitled to receive cumulative dividends of 8% per share per annum which were payable annually beginning on December 18, 2004, and were payable in cash, unless the Company completed its IPO before December 18, 2004. Since the IPO was not completed until February 2005, the dividends on the Series C Preferred Stock of approximately $665,000 were paid on January 18, 2005. Upon the closing of the Company's initial public offering during February 2005, the 109,962 outstanding shares of the Series C Preferred Stock were automatically converted into 3,141,838 shares of the Company's common stock and 3,141,838 Redeemable Common Stock Purchase Warrants. There was no beneficial conversion feature associated with this conversion.

Dividends

The holders of the Series A-1 Preferred Stock are entitled to receive cumulative dividends of 8% per annum payable in arrears, when and as declared by the Board, on January 1 of each year, commencing on January 1, 2008.

Voting

No holders of Preferred Stock had voting rights, except as provided by law.

16. Stock Options and Warrants

Under the Company's 1998 stock option plan (as amended), the Company has reserved 4,000,000 shares of common stock for issuance to employees at exercise prices determined by the Board of Directors. Options under the plan typically vest in annual increments over a three or four year period, expire ten years from the date of grant and are issued at exercise prices no less than 100% of the fair market value at the time of grant. As discussed in Note 2, through December 31, 2006.

On July 14, 2004, the Company's Stock Option Committee approved a recommendation to issue 446,057 options to its employees who had been previously granted stock options. Each employee received new options equal to 50% of their existing options priced at $3.15 per share and 50% at $4.38 per share, both with a four year vesting period and furthermore received credit for the vesting time on previously issued options, and the original options were cancelled if not exercised within six months and one day of the issuance of the new options (approximately 480,000 options were cancelled on January 14, 2005).

On December 19, 2005, the Nominating and Compensation Committee of the Company accelerated the vesting schedule on all stock options granted prior to November 18, 2005 to be fully vested as of December 19, 2005.

The following summary presents information regarding outstanding options as of December 31, 2006 and changes during the year then ended with regard to all options:

	Number Of Option	Weighted Average Exercise Price	Weighted Average Remaining Contract Term	Aggregate Intrinsic Value
Outstanding at January 1, 2006	2,100,798	$ 3.97		$ 488,792
Granted in 2006	852,148	$ 2.48		
Expired/cancelled in 2006	(120,400)	$ 3.59		
Outstanding at December 31, 2006	2,832,546	$ 3.54	5.72 years	$ -
Exercisable at December 31, 2006	1,799,446	$ 4.14	4.57 years	$ -

16. Stock Options and Warrants (continued)

Exercise Prices	Number of options	Weighted Average Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$1.17-2.28	253,861	9.08 years	$ 2.03	5,000	$ 2.28
$2.46-2.46	652,958	5.92 years	$ 2.46	305,863	$ 2.46
$2.65-3.15	635,730	5.73 years	$ 2.88	215,873	$ 3.14
$3.22-3.75	54,998	8.09 years	$ 3.56	37,711	$ 3.70
$4.38-6.45	1,234,999	4.82 years	$ 4.76	1,234,999	$ 4.76
	2,832,546			1,799,446	

The weighted-average estimated fair value of stock options granted was $ 3.54, $ 3.97 and $ 5.42 during the years ended December 31, 2006, 2005 and 2004 respectively. The total intrinsic value of stock options exercised during the years ended December 31, 2006, 2005 and 2004 was $0, $97,502 and $ 0, respectively. As of December 31, 2006, there was approximately $826,000 of total unrecognized compensation cost, net of estimated forfeitures, related to stock options granted under our stock incentive plans which is expected to be recognized over a weighted-average period of 2.46 years.

The Company, as part of various debt and other agreements, have issued warrants to purchase the Company's common stock. The following summarizes the information relating to warrants issued and the activity during 2006, 2005 and 2004:

	Number of Shares	**Per Share Warrant Price**	**Weighted Average Warrant Price**
Shares under warrants at January 1, 2004	252,758	$ 0.04-8.75	$ 3.33
Issued in 2004			
Shares under warrants at December 31, 2004	33,820	2.28-8.75	5.53
Issued in 2005	286,578	0.04-8.75	3.61
Exercised in 2005	7,281,838	6.45	6.45
Expired in 2005	(28,572)	2.98	2.98
Shares under warrants at December 31, 2005	(77,409)	2.98-8.75	4.15
Issued in 2006	7,462,435	0.04-6.45	6.37
Exercised in 2006	1,160,204	1.67	1.67
Expired in 2006	(14,286)	0.04	0.04
Shares under warrants at December 31, 2006	(19,644)	2.98-3.50	3.36
	8,588,709	$ 1.67-3.57	$ 5.75

All warrants are fully exercisable upon issuance other than the IPO warrants, which could not be exercised until the first anniversary of the date of the IPO.

17. Equity Transactions

During November 2006, $90,000 in payments due to Xtreme VoIP Corp. was paid with the issuance of 52,254 shares of common stock; as a result of certain earn outs having been met.

On March 28, 2006, the Company entered into a consulting service agreement. In connection with the agreement, the Company issued 50,000 shares of restricted common stock. Of these shares, 25,000 shares were given to the consultant upon the signing of the agreement. The other 25,000 shares were being held in escrow until the sixth (6th) month anniversary, at which time 12,500 shares were released. The remaining 12,500 shares will be released during 2007 as the agreement has not been terminated, pursuant to the Company's right to terminate. The $99,375 expense associated with the 37,500 shares given to the consultant during 2006 was amortized over the nine-month term.

As discussed further in Note 4, during March 2006, 675,581 shares of common stock held in escrow related to the acquisition of the minority interest in Efonica were released.

During March 2006, 14,286 shares of Common Stock were issued upon the exercise of a warrant to purchase the shares at a price of $0.035 per share.

18. Settlements of Debt

During 2006, the Company recognized a gain on settlement of debt of approximately $466,000. This was related to an agreement that the Company had previously entered into in 2003 with a vendor. The provisions of the original agreement provided that $555,000 due to the vendor would be resolved with a service agreement whereby the vendor received a reduced rate for services purchased from the Company through December 2005. The Company and the vendor continued to comply with the terms of this agreement until it was settled as discussed below. Since the inception of the settlement agreement, approximately $89,000 of the deferred revenue was recognized in connection with this service agreement. During June 2006, the service agreement was cancelled and the vendor released the Company of all remaining indebtedness under the December 2003 settlement agreement. Consequently, the remaining deferred revenue balance of approximately $466,000 was recorded as a gain on settlement of debt.

During the year ended December 31, 2005, the Company recognized both gains and a loss on debt settlements. The net of these settlements was a loss of approximately $76,000. The two significant settlements comprising this balance relates to a loss on settlement of debt of approximately $134,000 related to an international venture the Company was involved with during prior years. In addition, the Company entered into a settlement agreement with a vendor, which resulted in forgiveness of debt of approximately $43,000.

During 2004, the Company recorded approximately $2,175,000 related to forgiveness of debt. As of December 31, 2003, the Company had an outstanding capital lease obligation aggregating approximately $238,000. In January 2004, the Company entered into an agreement whereas the Company agreed to pay the sum of $45,000 resulting in a $193,000 forgiveness of debt. In addition, during 2004, the Company recorded approximately $1,982,000 of additional forgiveness of debt primarily related to settlements of network and general obligations.

19. Profit Sharing Plan

The Company has a defined contribution profit sharing plan, which covers all employees who meet certain eligibility requirements. Contributions to the plan are made at the discretion of the Board. No contributions to the profit sharing plan were made for the years ended December 31, 2006, 2005 and 2004.

20. Related Party Transactions

During the year ended December 31, 2006, the Company borrowed $100,000 from a stockholder of the Company, which was repaid on December 1, 2006. Interest was paid based upon an 8% interest rate.

During the year ended December 31, 2006, the Company entered into a promissory note agreement with a relative of an executive officer of the Company for the purpose of initiating operations in a foreign country. The promissory note is for $29,177, which is payable to the Company on demand.

Also during the year ended December 31, 2006, the Company received $655,000 from the members of its Board of Directors associated with the private placement for Preferred Stock, Series A-1 (See note 15).

At December 31, 2004, the Company had an aggregate of approximately $1,700,000 of long-term debt due to stockholders of the Company. In addition, the Company had approximately $539,000 of accrued interest outstanding on this related debt as of December 31, 2004. This debt and all interest accrued on the date of repayment was repaid during 2005. Interest expense related to this debt was approximately $18,000 and $230,000, for the years ended December 31, 2005 and 2004, respectively.

21. Concentrations

Major Customers

During 2006, three customers of the Company accounted for revenues exceeding 46% in total and at least 5% individually of the Company's total revenues for 2006. During 2005, six customers of the Company accounted for revenues exceeding 53% in total and at least 5% individually of the Company's total revenues for 2005. During 2004, two customers of the Company accounted for revenues exceeding 21% in total and at least 5% individually of the Company's total revenues for 2004. These customer revenues were all in the traditional voice and VoIP to carrier segments. Revenues earned from these customers were approximately $21,665,000 in 2006, $26,051,000 in 2005, and $10,479,000 in 2004. At December 31, 2006, 2005 and 2004, the amounts owed to the Company by these customers were approximately $4,398,000, $1,951,000, and $1,429,000, respectively.

Geographic Concentrations

The Company's operations are significantly influenced by economic factors and risks inherent in conducting business in foreign countries, including government regulations, currency restrictions and other factors that may significantly affect management's estimates and the Company's performance.

During 2006, 2005 and 2004, the Company generated approximate revenue from continuing operations from customers in the following countries:

	2006	2005	2004
United States	$ 42,559,000	$ 44,166,000	$ 46,248,000
Other	4,528,000	5,199,000	3,310,000
	$ 47,087,000	$ 49,365,000	$ 49,558,000

At December 31, 2006 and 2005, the Company had foreign long-lived assets in foreign countries as follows:

	2006	2005
Jamaica	$ 129,000	$ 245,000

Revenues by geographic area are based upon the location of the customers. The foreign long-lived assets by geographic area represent those assets physically used in the operations in each geographic area.

22. Segment Information

The Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". SFAS No. 131 requires disclosures of segment information on the basis that is used internally for evaluating segment performance and deciding how to allocate resources to segments.

The Company has two reportable segments that it operates and manages which are organized by products and services. The Company measures and evaluates its reportable segments based on revenues and cost of revenues. This segment income excludes unallocated corporate expenses and other adjustments arising during each period. The other adjustments include transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-operational and/or non-recurring nature. Although such transactions are excluded from the business segment results, they are included in reported consolidated earnings. Each segment is managed according to the products, which are provided to the respective customers, and information is reported on the basis of reporting to the Company's Chief Operating Decision Maker. In previous years, the Company had three reportable segments with Consumers, Corporations and Other broken out into two separate segments. Since the Company's Chief Operating Decision Maker currently reviews these segments as one, the segment disclosures for the year ended December 31, 2005 have been presented in a consistent manner.

The Company's segments and their principal activities consist of the following:

Voice to Carriers - Voice to Carriers includes VoIP to Carriers, which is the termination of voice telephony minutes by the Internet, as well as traditional voice termination. VoIP permits a less costly and more rapid interconnection between the Company and international telecommunications carriers. Traditional termination of voice telephony minutes from or to the countries served by the Company utilizes Time Division Multiplexing (TDM) and "circuit-switched" technology. Typically, this will include interconnection with traditional telecommunications carriers either located internationally, or those carriers that interconnect with the Company at its U.S. Points of Presence (POP) and provide service to other destinations. These minutes are sold to carriers on a wholesale basis.

Consumers, Corporations and Other - The Company provides VoIP services targeted to end-users and corporations, primarily through its Efonica brand. The Company offers services that permit consumers or corporations to originate calls via IP telephones or telephone systems that use the Internet for completion to standard telephone lines anywhere in the world. It provides PC-to-phone service that utilizes the Internet to allow consumers to use their personal computers to place calls to the telephone of their destination party. Additionally, the Company provides Internet connectivity to telecommunications carriers, Internet service providers, government entities, and multinational customers via its POPs in the U.S. and India, and through its partners elsewhere. The Company also offers point-to-point private lines, virtual private networking, and call center communications services to customers in its target markets.

22. Segment Information (continued)

Operating segment information for 2006 and 2005 is summarized as follows:

	2006			
	Voice to Carriers	Consumers, Corporations and Other	Corporate & Unallocated	Consolidated
Revenues	$ 43,646,206	$ 3,440,858	$ —	$ 47,087,064
Cost of revenues (exclusive of depreciation and amortization)	$ (40,024,199)	$ (2,439,525)	$ —	$ (42,463,724)
Depreciation and amortization	$ (1,230,331)	$ (166,763)	$ —	$ (1,397,094)
Loss on impairment	$ —	$ (867,212)	$ —	$ (867,212)
Selling, general and administrative	$ (8,557,961)	$ (5,908,256)	$ (336,845)	$ (14,803,062)
Advertising and marketing	$ (73,530)	$ (1,262,215)	$ —	$ (1,335,745)
Other income (expense)	$ 311,586	$ 285,856	$ —	$ 597,442
Loss from continuing operations	$ (5,928,229)	$ (6,917,257)	$ (336,845)	$ (13,182,331)
Income from discontinued operations	$ 84,000	$ (252,871)	$ —	$ (168,871)
Net income (loss)	$ (5,844,229)	$ (7,170,128)	$ (336,845)	$ (13,351,202)
Assets	$ 11,664,585	$ 13,129,701	$ 2,779,014	$ 27,573,300
Capital Expenditures	$ 983,700	$ 2,315,498	$ —	$ 3,299,198

	2005			
	Voice to Carriers	Consumers Corporations and Other	Corporate & Unallocated	Consolidated
Revenues	$ 43,608,538	$ 5,756,004	$ —	$ 49,364,542
Cost of revenues (exclusive of depreciation and amortization)	$ (41,070,944)	$ (3,977,973)	$ —	$ (45,048,917)
Depreciation and amortization	$ (1,455,548)	$ (54,624)	$ —	$ (1,510,172)
Selling, general and administrative	$ (7,827,601)	$ (3,721,024)	$ (85,088)	$ (11,633,713)
Advertising and marketing	$ (11,358)	$ (164,367)	$ —	$ (175,725)
Other income (expense)	$ (517,130)	$ (80,966)	$ —	$ (598,096
Loss from continuing operations	$ (7,274,043)	$ (2,242,950)	$ (85,088)	$ (9,602,081)
Income from discontinued operations	$ 202,146	$ 4,861	$ —	$ 207,007
Net income (loss)	$ (7,071,897)	$ (2,238,089)	$ (85,088)	$ (9,395,074)
Assets	$ 7,516,881	$ 10,775,423	$ 16,093,423	$ 34,385,779
Capital Expenditures	$ 1,492,525	$ 197,002	$ 187,725	$ 1,877,252

The Company employs engineering and operations resources that service across multiple product lines. Depreciation and indirect operating expenses were allocated to each product line based upon their respective percent utilization of the resources. The amounts reflected as Corporate & Unallocated represent those expenses that were not appropriate to allocate to each product line.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

23. Subsequent Events

There have been no subsequent events to report.

24. Selected Quarterly Results (Unaudited)

	2006			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	$ 9,522,158	$ 10,543,112	$ 11,728,524	$ 15,293,270
Operating loss	$ (2,990,639)	$ (3,349,123)	$ (3,755,453)	$ (3,684,558)
Interest income	$ 133,461	$ 102,117	$ 58,694	$ 24,061
Interest expense	$ (30,000)	$ (29,514)	$ (30,972)	$ (23,520)
Gain (loss) on settlements of debt	$ —	$ 465,854	$ —	$ —
Net loss	$ (2,954,060)	$ (2,801,691)	$ (3,926,049)	$ (3,669,402)
Basic and diluted net loss per common share applicable to common stockholders	$ (0.11)	$ (0.10)	$ (0.15)	$ (0.14)

	2005			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	$ 11,929,052	$ 19,259,891	$ 9,123,742	$ 9,051,857
Operating loss	$ (2,206,801)	$ (1,893,855)	$ (2,315,426)	$ (2,587,903)
Interest income	$ 56,327	$ 126,543	$ 139,733	$ 151,506
Interest expense	$ (332,130)	$ (35,163)	$ (32,457)	$ (34,999)
Gain (loss) on settlements of debt	$ —	$ 5,340	$ 52,539	$ (133,806)
Net loss	$ (2,465,591)	$ (1,900,881)	$ (2,341,140)	$ (2,687,462)
Basic and diluted net loss per common share applicable to common stockholders	$ (0.12)	$ (0.07)	$ (0.09)	$ (0.10)

FUSION TELECOMMUNICATIONS INTERNATIONAL, INC.
AND SUBSIDIARIES

SCHEDULE II

VALUATION AND QUALIFYING ACCOUNTS

	Balance at Beginning of Period	Additions Charged to Expense	Deductions from Reserves	Balance at End of Period
Allowance for Doubtful Accounts for the Years Ended:				
December 31, 2006(1)	$ 1,247,535	$ 404,750	$ 543,952	$ 1,108,333
December 31, 2005(1)	1,058,414	350,434	161,313	1,247,535
December 31, 2004(1)	687,490	780,479	409,555	1,058,414
Tax Valuation Account for the Years Ended:				
December 31, 2006	$ 23,076,000	$ 3,884,000	$ —	$ 26,969,000
December 31, 2005	25,682,000	—	2,606,000	23,076,000
December 31, 2004	23,964,000	1,718,000	—	25,682,000

(1) Additions charged to expense and balance at end of period includes amounts associated with the Company's equity investment in Estel. This allowance is net against the liability balance that is included in Investment in Estel on the Company's Consolidated Balance Sheets.

EXHIBIT 31.1

CERTIFICATION

I, Matthew D. Rosen, certify that:

1. I have reviewed this report on Form 10-K of Fusion Telecommunications International, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 2, 2007

By: /s/ Matthew D. Rosen
Name: Matthew D. Rosen
Title: Chief Executive Officer and President

EXHIBIT 31.2

CERTIFICATION

I, Barbara Hughes, certify that:

6. I have reviewed this report on Form 10-K of Fusion Telecommunications International, Inc.;

7. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

8. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

9. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

10. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 2, 2007

By: /s/ Barbara Hughes
Name: Barbara Hughes
Title: Chief Financial Officer and Principal Accounting and Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Fusion Telecommunications International, Inc. (the "Company") on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Matthew D. Rosen, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss.906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company for the periods presented therein.

Date: April 2, 2007

By: /s/ Matthew D. Rosen
Name: Matthew D. Rosen
Title: Chief Executive Officer and President

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Fusion Telecommunications International, Inc. (the "Company") on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Barbara Hughes, Chief Financial Officer and Principal Accounting and Financial Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, a s adopted pursuant to ss.906 of the Sarbanes-Oxley Act of 2002, that:

3. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

4. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company for the periods presented therein.

Date: April 2, 2007

By: /s/ Barbara Hughes
Name: Barbara Hughes
Title: Chief Financial Officer and Principal Accounting and Financial Officer