SOYO GROUP INC
Form 10-Q
August 23, 2004

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

FORM 10-Q

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

For the quarterly period ended June 30, 2004

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934

For the transition period from ________ to _________

Commission file number: 333-42036

Soyo Group, Inc.
(Exact name of registrant as specified in its charter)

Nevada	95-4502724
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1420 South Vintage Avenue, Ontario, California	91761
(Address of principal executive offices)	(Zip Code)

(909) 292-2500
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by 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 [X] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). [ ]

As of June 30, 2004, the registrant had 40,000,000 shares of common stock issued and outstanding.

Documents incorporated by reference: None.

SOYO GROUP, INC. AND SUBSIDIARY

INDEX

Soyo Group, Inc. and Subsidiary
Condensed Consolidated Balance Sheets

	June 30,	December 31,

	2004	2003
	(Unaudited)	
ASSETS		
CURRENT		
Cash and cash equivalents	$ 524,116	$ 717,196
Accounts receivable, net of allowance for doubtful accounts of $1,052,720 and $856,386 at June 30, 2004 and December 31, 2003, respectively	6,095,636	6,818,729
Inventories, including $3,752,122 and $3,426,342 purchased from Soyo Computer, Inc. at June 30, 2004 and December 31, 2003, respectively	6,897,974	5,036,125
Prepaid expenses	15,380	43,973
Income tax refund receivable	47,000	47,000
	13,580,106	12,663,023
Property and equipment	206,177	86,483
Less: accumulated depreciation and amortization	(53,356)	(45,088)
	152,821	41,395
Deposits	20,035	25,035
	$ 13,752,962	$ 12,729,453

(continued)

Soyo Group, Inc. and Subsidiary

Condensed Consolidated Balance Sheets (continued)

	June 30, 2004	December 31, 2003
	(Unaudited)	
LIABILITIES		
CURRENT		
Accounts payable -		
Soyo Computer, Inc.	$ 5,485,436	$ 6,557,253
Other	7,080,344	5,475,999
Accrued liabilities	825,718	592,984
Advances from officer, director and major shareholder	418,573	240,000
Note payable	913,750	--
	14,723,821	12,866,236
NON-CURRENT		
Long-term payable - Soyo Computer, Inc.	--	12,000,000
SHAREHOLDERS' DEFICIENCY		
Preferred stock, $0.001 par value		
Authorized - 10,000,000 shares		
Issued and outstanding -		
1,000,000 shares of Class A Convertible Preferred Stock, $1.00 per share stated liquidation value ($1,000,000 aggregate liquidation value)	1,000	1,000
2,500,000 shares of Class B Convertible Preferred Stock, $1.00 per share stated liquidation value ($2,500,000 aggregate liquidation value)	1,375,773	--
Common stock, $0.001 par value		
Authorized - 75,000,000 shares		
Issued and outstanding -		
40,000,000 shares	40,000	40,000
Additional paid-in capital	11,155,000	459,000
Accumulated deficit	(13,542,632)	(12,636,783)
	(970,859)	(12,136,783)
	$ 13,752,962	$ 12,729,453

See accompanying notes to condensed consolidated financial statements.

4

Soyo Group, Inc. and Subsidiary
Condensed Consolidated Statements of Operations (Unaudited)

	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003 (Restated - Note 6)
Net revenues	$ 10,194,388	$ 6,901,834
Cost of revenues, including inventories purchased from Soyo Computer, Inc. of $4,237,613 and $3,223,324 in 2004 and 2003, respectively	9,795,416	5,491,660
Gross margin	398,972	1,410,174
Costs and expenses:		
Sales and marketing	262,136	254,487
General and administrative	1,027,198	985,469
Provision for doubtful accounts	29,462	--
Depreciation and amortization	4,212	4,039
Total costs and expenses	1,323,008	1,243,995
Income (loss) from operations	(924,036)	166,179
Other income (expense):		
Interest income	--	25,219
Interest expense	(4,745)	(10,026)
Other income (expense), net	(4,745)	15,193
Income (loss) before provision for income taxes	(928,781)	181,372
Provision for income taxes	--	28,750
Net income (loss)	(928,781)	152,622
Less: Dividends on Class B Convertible Preferred Stock	(71,773)	--
Net income (loss) available to common shareholders	$ (1,000,554)	$ 152,622
Net income (loss) per common share -		
Basic	$ (0.03)	$ --
Diluted	$ (0.03)	$ --
Weighted average number of common shares outstanding -		
Basic	40,000,000	40,000,000

Diluted	40,000,000	45,555,556

See accompanying notes to condensed consolidated financial statements.

Soyo Group, Inc. and Subsidiary
Condensed Consolidated Statements of Operations (Unaudited)

	Six Months Ended June 30,	
	2004	2003
		(Restated - Note 6)
Net revenues	$ 18,788,690	$ 16,399,399
Cost of revenues, including inventories purchased from Soyo Computer, Inc. of $9,953,689 and $8,157,725 in 2004 and 2003, respectively	17,276,550	13,818,359
Gross margin	1,512,140	2,581,040
Costs and expenses:		
Sales and marketing	299,288	473,433
General and administrative	1,837,581	1,793,509
Provision for doubtful accounts	196,335	--
Depreciation and amortization	8,267	8,074
Total costs and expenses	2,341,471	2,275,016
Income (loss) from operations	(829,331)	306,024
Other income (expense):		
Interest income	--	25,224
Interest expense	(4,745)	(19,425)
Other income (expense), net	(4,745)	5,799
Income (loss) before provision for income taxes	(834,076)	311,823
Provision for income taxes	--	65,000
Net income (loss)	(834,076)	246,823
Less: Dividends on Class B Convertible Preferred Stock	(71,773)	--
Net income (loss) available to common shareholders	$ (905,849)	$ 246,823
Net income (loss) per common share - Basic	$ (0.02)	$ 0.01

Diluted	$ (0.02)	$ 0.01
Weighted average number of common shares outstanding -		
Basic	40,000,000	40,000,000
Diluted	40,000,000	45,555,556

See accompanying notes to condensed consolidated financial statements.

6

Soyo Group, Inc. and Subsidiary
Condensed Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30,	
	2004	2003 (Restated - Note 6)
OPERATING ACTIVITIES		
Net income (loss)	$ (834,076)	$ 246,823
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	8,267	8,074
Provision for doubtful accounts	196,335	--
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	526,759	2,892,659
Inventories	(1,861,849)	4,919,827
Prepaid expenses	28,593	21,945
Deposits	5,000	--
Increase (decrease) in:		
Accounts payable - Soyo Computer, Inc.	(1,071,817)	(5,802,599)
Accounts payable - other	1,604,345	(2,879,099)
Accrued liabilities	232,734	(257,013)
Income taxes payable	--	64,750
Net cash used in operating activities	(1,165,709)	(784,633)
INVESTING ACTIVITIES		
Additions to property and equipment	(119,694)	--
Net cash used in investing activities	(119,694)	--

(continued)

Soyo Group, Inc. and Subsidiary
Condensed Consolidated Statements of Cash Flows (Unaudited) (continued)

	Six Months Ended June 30, 2004	2003 (Restated - Note 6)
FINANCING ACTIVITIES		
Advances from officer, director and major shareholder	$ 178,573	$ 360,000
Net decrease in revolving note payable	--	(197,000)
Proceeds from issuance of note payable	913,750	--
Net cash provided by financing activities	1,092,323	163,000
CASH AND CASH EQUIVALENTS		
Net decrease	(193,080)	(621,633)
At beginning of period	717,196	623,296
At end of period	$ 524,116	$ 1,663
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for -		
Interest	$ --	$ 13,020
Income taxes	$ --	$ 1,050
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Issuance of 2,500,000 shares of Class B		

Convertible Preferred Stock as settlement of $12,000,000 long-term payable -		
Preferred stock	$ 1,304,000	$ --
Additional paid-in capital	$ 10,696,000	$ --
Accreted dividends added to preferred stock	$ 71,773	$ --

See accompanying notes to condensed consolidated financial statements.

Soyo Group, Inc. and Subsidiary
Notes to Condensed Consolidated Financial Statements (Unaudited)
Three Months and Six Months Ended June 30, 2004 and 2003

1. Organization and Basis of Presentation

Organization - Effective October 24, 2002, Vermont Witch Hazel Company, Inc., a Nevada corporation ("VWHC"), acquired Soyo, Inc., a Nevada corporation ("Soyo Nevada"), from Soyo Computer, Inc., a Taiwan corporation ("Soyo Taiwan), in exchange for the issuance of 1,000,000 shares of convertible preferred stock and 28,182,750 shares of common stock, and changed its name to Soyo Group, Inc. ("Soyo"). The 1,000,000 shares of preferred stock were issued to Soyo Taiwan and the 28,182,750 shares of common stock were issued to certain members of Soyo Nevada management.

Subsequent to this transaction, Soyo Taiwan maintained an equity interest in Soyo, continued to be the primary supplier of inventory to Soyo, and was a major creditor. In addition, there was no change in the management of Soyo and no new capital invested, and there was a continuing family relationship between certain members of the management of Soyo and Soyo Taiwan. As a result, this transaction was accounted for as a recapitalization of Soyo Nevada, pursuant to which the accounting basis of Soyo Nevada continued unchanged subsequent to the transaction date. Accordingly, the pre-transaction financial statements of Soyo Nevada are now the historical financial statements of the Company.

In conjunction with this transaction, Soyo Nevada transferred $12,000,000 of accounts payable to Soyo Taiwan to long-term payable, without interest, due December 31, 2005. During the three months ended March 31, 2004, the Company agreed with a third party to convert the long-term payable into convertible preferred stock.

Soyo Taiwan also agreed to continue to provide computer parts and components to Soyo on an open account basis at the quantities required and on a timely basis to enable Soyo to continue to conduct its business operations at budgeted levels, which is not less than a level consistent with the operations of Soyo Nevada's business in 2001 and 2000. This supply commitment is effective through December 31, 2005.

On December 9, 2002, Soyo's Board of Directors elected to change Soyo's fiscal year end from July 31 to December 31 to conform to Soyo Nevada's fiscal year end.

On October 24, 2002, the primary members of Soyo Nevada management were Ming Tung Chok, the Company's President, Chief Executive Officer and Director, and Nancy Chu, the Company's Chief Financial Officer. Ming Tung Chok and Nancy Chu are husband and wife. Andy Chu, the President and major shareholder of Soyo Taiwan, is the brother of Nancy Chu.

Unless the context indicates otherwise, Soyo and its wholly-owned subsidiary, Soyo Nevada, are referred to herein as the "Company".

Basis of Presentation - The accompanying condensed consolidated financial statements include the accounts of Soyo and Soyo Nevada. All significant intercompany accounts and transactions have been eliminated in consolidation. The condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles. The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The carrying amounts of assets and liabilities presented in the consolidated financial statements do not purport to represent the realizable or settlement values, and do not include any adjustments that might result from the outcome of this uncertainty.

Interim Financial Statements - The accompanying interim condensed consolidated financial statements are unaudited, but in the opinion of management of the Company, contain all adjustments, which include normal recurring adjustments, necessary to present fairly the financial position at June 30, 2004, the results

of operations for the three months and six months ended June 30, 2004 and 2003, and cash flows for the six months ended June 30, 2004 and 2003. The condensed consolidated balance sheet as of December 31, 2003 is derived from the Company's audited consolidated financial statements.

Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, although management of the Company believes that the disclosures contained in these condensed consolidated financial statements are adequate to make the information presented therein not misleading. For further information, refer to the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, as filed with the Securities and Exchange Commission.

The preparation of financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant estimates primarily relate to the realizable value of accounts receivable, vendor programs and inventories. Actual results could differ from those estimates.

The results of operations for the three months and six months ended June 30, 2004 is not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2004.

Business - The Company sells computer components and peripherals to distributors and retailers primarily in North, Central and South America. The Company operates in one business segment. A substantial majority of the Company's products are purchased from Soyo Taiwan pursuant to an exclusive distribution agreement effective through December 31, 2005, and are sold under the "Soyo" brand. Inventories consist primarily of computer parts and components.

Earnings Per Share - Statement of Financial Accounting Standards No. 128, "Earnings Per Share", requires presentation of basic earnings per share ("Basic EPS") and diluted earnings per share ("Diluted EPS"). Basic income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted income per share gives effect to all dilutive potential common shares outstanding during the period. Potentially dilutive securities consist of the outstanding shares of preferred stock.

As of June 30, 2004, potentially dilutive securities consisted of 1,000,000 shares of Class A Convertible Preferred Stock with a stated liquidation value of $1.00 per share that are convertible into common stock at fair market value, and 2,500,000 shares of Class B Convertible Preferred Stock with a stated liquidation value of $1.00 per share that are convertible into common stock at fair market value, but not less than $0.25 per share.

As of June 30, 2004, 17,692,308 shares of common stock were issuable upon conversion of the Class A Convertible Preferred Stock and the Class B Convertible Preferred Stock, consisting of 7,692,308 shares of common stock issuable upon conversion of the Class A Convertible Preferred Stock, based on the closing price of $0.13 per common share at June 30, 2004, which was less than the average price of $0.15 per common share during the six months ended June 30, 2004, and 10,000,000 shares of common stock issuable upon conversion of the Class B Convertible Preferred Stock, based on the $0.25 per share minimum conversion price.

10

For the three months ended June 30, 2003, 5,555,556 shares of common stock were issuable upon conversion of the Class A convertible preferred stock, based on the trading price of the common stock on June 30, 2003 of $0.18 per share, which information was utilized to calculate diluted income per share.

For the six months ended June 30, 2003, 5,555,556 shares of common stock were issuable upon conversion of the Class A convertible preferred stock, based on the trading price of the common stock on June 30, 2003 of $0.18 per share, which information was utilized to calculate diluted income per share.

Comprehensive Income (Loss) - The Company displays comprehensive income or loss, its components and accumulated balances in its consolidated financial statements. Comprehensive income or loss includes all changes in equity except those resulting from investments by owners and distributions to owners. The Company did not have any items of comprehensive income (loss) during the three months and six months ended June 30, 2004 and 2003.

Significant Risks and Uncertainties - The Company operates in a highly competitive industry subject to aggressive pricing practices, pressures on gross margins, frequent introductions of new products, rapid technological advances, continual improvement in product price/performance characteristics, and changing consumer demand.

As a result of the dynamic nature of the business, it is possible that the Company's estimates with respect to the realizability of inventories and accounts receivable may be materially different from actual amounts. These differences could result in higher than expected allowance for bad debts or inventory reserve costs, which could have a materially adverse effect on the Company's financial position and results of operations.

Stock-Based Compensation - The Company has adopted Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), which establishes a fair value method of accounting for stock-based compensation plans, as amended by Statement of Financial Accounting Standard No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS No. 148").

The provisions of SFAS No. 123 allow companies to either expense the estimated fair value of stock options or to continue to follow the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", but to disclose the pro forma effect on net loss and net loss per share had the fair value of the stock options been exercised. The Company has elected to continue to account for stock-based compensation plans utilizing the intrinsic value method. Accordingly, compensation cost for stock options will be measured as the excess, if any, of the fair market price of the Company's common stock at the date of grant above the amount an employee must pay to acquire the common stock.

In accordance with SFAS No. 123, as amended by SFAS No. 148, the Company will provide prominent footnote disclosure with respect to stock-based employee compensation, and the effect of the method used on reported results. The value of a stock-based award will be determined using the Black-Scholes option-pricing model, whereby compensation cost is the fair value of the award as determined by the pricing model at the grant date or other measurement date. The resulting amount will be charged to expense on the straight-line basis over the period in which the Company expects to receive benefit, which is generally the vesting period. Stock options issued to non-employee directors at fair market value will be accounted for under the intrinsic value method.

The Company has not issued any stock-based compensation to date. Accordingly, no pro forma financial disclosure has been presented.

2. Advances from Officer, Director and Major Shareholder

During March 2003, Nancy Chu, the Company's Chief Financial Officer, director and major shareholder, made short-term advances to the Company of $360,000 for working capital purposes, of which $120,000 was repaid during September 2003.

During the six months ended June 30, 2004, the Company received a loan of $178,573, which has been recorded as an advance from Ms. Chu. These loans are non-interest bearing and due on demand.

3. Note Payable

On March 29, 2004, LGT Computer, Inc. loaned the Company $213,750 pursuant to an unsecured note payable due March 28, 2005, with interest at 4% per annum. On May 29, 2004, LGT Computer, Inc. loaned the Company an additional $700,000 pursuant to an unsecured note payable due May 29, 2005, with interest at 4% per annum. The principal stockholder and officer of LGT Computer, Inc. is an employee of the Company.

4. Equity-Based Transactions

Effective December 30, 2003, Soyo Taiwan entered into an agreement with an unrelated third party to sell the $12,000,000 long-term payable due it by the Company. As part of the agreement, Soyo Taiwan required that the purchaser would be limited to collecting a maximum of $1,630,000 of the $12,000,000 from the Company without the prior consent of Soyo Taiwan. In substance, Soyo Taiwan forgave debt in an amount equal to the difference between the $12,000,000 and the value of the preferred stock issued in settlement of this debt. This forgiveness of debt was treated as a capital transaction. Payment from the third party was received by Soyo Taiwan in February and March 2004. An agreement was reached during the three months ended March 31, 2004 whereby 2,500,000 shares of Class B preferred stock would be issued by the Company to the unrelated third party in exchange for the long-term payable.

The Class B preferred stock has a stated liquidation value of $1.00 per share and a 6% dividend, payable quarterly in arrears, in the form of cash, additional shares of preferred stock, or common stock, at the option of the Company. The Class B preferred stock has no voting rights. The shares of Class B preferred stock are convertible, in increments of 100,000 shares, into shares of common stock based on the $1.00 stated value, at any time through December 31, 2008, based on the fair market value of the common stock, subject, however, to a minimum conversion price of $0.25 per share. No more than 500,000 shares of Class B preferred stock may be converted into common stock in any one year. On December 31, 2008, any unconverted shares of Class B preferred stock automatically convert into shares of common stock based on the fair market value of the common stock, subject, however, to a minimum conversion price of $0.25 per share. Beginning one year after issuance, upon ten days written notice, the Company or its designee will have the right to repurchase for cash any portion or all of the outstanding shares of Class B preferred stock at 80% of the liquidation value ($0.80 per share). During such notice period, the holder of the preferred stock will have the continuing right to convert any such preferred shares pursuant to which written notice has been received into common stock without regard to the conversion limitation. The Class B preferred stock has unlimited piggy-back registration rights, and is non-transferrable.

The Company recorded the issuance of the Class B preferred stock at its fair market value on March 31, 2004 of $1,304,000, which was determined by an independent investment banking firm. The $10,696,000 difference between the $12,000,000 long-term payable and the $1,304,000 fair market value of the Class B preferred stock was credited to additional paid-in capital. The difference between the fair market value and the liquidation value of the Class B preferred stock is being recognized as an additional dividend to the Class B preferred stockholder, and as a reduction to earnings available to common stockholders, and is being accreted from April 1, 2004 through December 31, 2008.

5. Significant Concentrations

a. Customers

The Company sells to both distributors and retailers. Revenues through such distribution channels are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Revenues				
Retailers	$ 5,231,703	$ 5,743,827	$11,578,540	$13,371,372
Distributors	4,876,737	1,158,007	6,984,557	3,028,027

Other	85,948	--	225,593	--
	$10,194,388	$ 6,901,834	$18,788,690	$16,399,399

During the three months ended June 30, 2004 and 2003, the Company offered price protection to certain customers under specific programs aggregating $70,959 and $605,746, respectively, which reduced net revenues and accounts receivable accordingly.

During the six months ended June 30, 2004 and 2003, the Company offered price protection to certain customers under specific programs aggregating $74,589 and $1,473,000, respectively, which reduced net revenues and accounts receivable accordingly.

Information with respect to customers that accounted for 10% or more of the Company's revenues is presented below.

During the three months ended June 30, 2004, the Company had two customers that accounted for revenues of $2,871,468 and $1,523,800, respectively, equivalent to 28.2% and 15.0% of net revenues, respectively. During the three months ended June 30, 2003, the Company had two customers that accounted for revenues of $1,220,740 and $800,555, respectively, equivalent to 17.8% and 11.7% of net revenues, respectively.

During the six months ended June 30, 2004, the Company had two customers that accounted for revenues of $5,072,250 and $1,955,900, respectively, equivalent to 27.0% and 10.4% of net revenues, respectively. During the six months ended June 30, 2003, the Company had two customers that accounted for revenues of $4,092,491 and $2,087,322, respectively, equivalent to 24.9% and 12.7% of net revenues, respectively.

b. Geographic Segments

Financial information by geographic segments is summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Revenues				
North America	$ 7,554,427	$ 5,538,060	$ 14,290,159	$ 13,656,527
Central and South America	2,551,877	1,107,890	4,270,125	2,254,915
Other locations	88,084	255,884	228,406	487,957
	$ 10,194,388	$ 6,901,834	$ 18,788,690	$ 16,399,399

13

c. Suppliers

A substantial majority of the Company's inventories are manufactured by Soyo Taiwan and are purchased from Soyo Taiwan or an affiliate of Soyo Taiwan on an open account basis.

Through October 24, 2002, Soyo Nevada was a wholly-owned subsidiary of Soyo

Taiwan (see Note 1). Subsequent to that date, Soyo Taiwan has agreed to provide inventory to Soyo on an open account basis through December 31, 2005.

The following is a summary of the Company's transactions and balances with Soyo Taiwan as of June 30, 2004 and December 31, 2003, and for the three months and six months ended June 30, 2004 and 2003:

	June 30, 2004	December 31, 2003
Accounts payable to Soyo Taiwan	$ 5,485,436	$ 6,557,253
Long-term payable to Soyo Taiwan	-	12,000,000

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Purchases from Soyo Taiwan	$ 6,548,225	$ 867,742	$11,031,169	$ 6,835,113
Payments to Soyo Taiwan	6,757,919	5,260,000	12,102,986	12,867,000

During the three months and six months ended June 30, 2003, the Company received price protection from Soyo Taiwan aggregating $343,415 and $435,415, respectively, which reduced inventories and accounts payable to Soyo Taiwan accordingly. The Company did not receive any price protection from Soyo Taiwan during the three months and six months ended June 30, 2004.

6. Restatement

In conjunction with the audit of the Company's consolidated financial statements for the year ended December 31, 2003, the Company conducted a review of its 2003 interim financial statements. As a result of this review, the Company restated its results of operations for the three months ended March 31, 2003, June 30, 2003 and September 30, 2003, to reflect various adjustments, primarily to correct the intra-period allocation of net revenues and cost of revenues.

The adjustments to the statement of operations for the three months and six months ended June 30, 2003 are summarized as follows:

14

	Three Months Ended June 30, 2003	Six Months Ended June 30, 2003
Net income, as reported	$ 302,274	$ 667,778
Adjustments to:		
Increase (decrease) revenues	39,758	(47,063)
Increase cost of revenues	(157,250)	(317,807)

Increase selling, general and administrative expenses	(32,160)	(56,085)
Net income, as revised	$ 152,622	$ 246,823
Net income per common share (basic and diluted), as reported	$ --	$ 0.01
Net income per common share (basic and diluted), as revised	$ --	$ 0.01
Weighted average number of common shares outstanding -		
Basic	40,000,000	40,000,000
Diluted	45,555,556	45,555,556

15

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

This Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2004 contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, including statements that include the words "believes", "expects", "anticipates", or similar expressions. These forward-looking statements include, but are not limited to, statements concerning the Company's expectations regarding its working capital requirements, financing requirements, business prospects, and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. The forward-looking statements in this Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2004 involve known and unknown risks, uncertainties and other factors that could cause the actual results, performance or achievements of the Company to differ materially from those expressed in or implied by the forward-looking statements contained herein.

Background and Overview:

The Company sells computer components and peripherals to distributors and retailers primarily in North, Central and South America. The Company operates in one business segment. A substantial majority of the Company's products are purchased from Soyo Taiwan pursuant to an exclusive distribution agreement effective through December 31, 2005, and are sold under the "Soyo" brand.

Effective October 24, 2002, Vermont Witch Hazel Company, Inc., a Nevada corporation ("VWHC"), acquired Soyo, Inc., a Nevada corporation ("Soyo Nevada"), from Soyo Computer, Inc., a Taiwan corporation ("Soyo Taiwan), in exchange for the issuance of 1,000,000 shares of convertible preferred stock and 28,182,750 shares of common stock, and changed its name to Soyo Group, Inc. ("Soyo"). The 1,000,000 shares of preferred stock were issued to Soyo Taiwan and the 28,182,750 shares of common stock were issued to certain members of Soyo Nevada management. During October 2002, certain members of the management of Soyo Nevada also separately purchased 6,026,798 shares of the 11,817,250 shares of common stock of VWHC outstanding prior to VWHC's acquisition of Soyo Nevada, for $300,000 in personal funds. The 6,026,798 shares represented 51% of the outstanding shares of VWHC common stock. Accordingly, Soyo Nevada management currently owns 34,209,548 shares of the 40,000,000 shares of the Company's common stock outstanding.

Subsequent to this transaction, Soyo Taiwan maintained an equity interest in Soyo, continued to be the primary supplier of inventory to Soyo, and was a major creditor. In addition, there was no change in the management of Soyo and no new capital invested, and there was a continuing family relationship between certain members of the management of Soyo and Soyo Taiwan. As a result, for financial reporting purposes, this transaction was accounted for as a recapitalization of Soyo Nevada, pursuant to which the accounting basis of Soyo Nevada continued unchanged subsequent to the transaction date. Accordingly, the pre-transaction financial statements of Soyo Nevada are now the historical financial statements of the Company.

Unless the context indicates otherwise, Soyo and its wholly-owned subsidiary, Soyo Nevada, are referred to herein as the "Company".

The Company sells to both distributors and retailers. Revenues through such distribution channels are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Revenues				
Retailers	$ 5,231,703	$ 5,743,827	$11,578,540	$13,371,372
Distributors	4,876,737	1,158,007	6,984,557	3,028,027
Other	85,948	--	225,593	--
	$10,194,388	$ 6,901,834	$18,788,690	$16,399,399

Information with respect to customers that accounted for 10% or more of the Company's revenues is presented below.

During the three months ended June 30, 2004, the Company had two customers that accounted for revenues of $2,871,468 and $1,523,800, respectively, equivalent to 28.2% and 15.0% of net revenues, respectively. During the three months ended June 30, 2003, the Company had two customers that accounted for revenues of $1,220,740 and $800,555, respectively, equivalent to 17.8% and 11.7% of net revenues, respectively.

During the six months ended June 30, 2004, the Company had two customers that accounted for revenues of $5,072,250 and $1,955,900, respectively, equivalent to 27.0% and 10.4% of net revenues, respectively. During the six months ended June 30, 2003, the Company had two customers that accounted for revenues of $4,092,491 and $2,087,322, respectively, equivalent to 24.9% and 12.7% of net revenues, respectively.

Financial information by geographic segments is summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Revenues				
North America	$ 7,554,427	$ 5,538,060	$ 14,290,159	$ 13,656,527
Central and South America	2,551,877	1,107,890	4,270,125	2,254,915
Other locations	88,084	255,884	228,406	487,957
	$ 10,194,388	$ 6,901,834	$ 18,788,690	$ 16,399,399

Financial Outlook:

During early 2003, as a result of the Company changing its product mix to focus on the sales of higher margin products and the decrease in market pressures on the Company's gross margin resulting from the West Coast dock strike in September and early October 2002, the Company's gross margin improved compared to 2002. The Company's sales for the year ended December 31, 2003 were $31,034,239, with a gross margin of 9.9%. For the six months ended June 30, 2004, the Company's sales were $18,788,690, as compared to $16,399,399 for the six months ended June 30, 2003, an increase of $2,389,291 or 14.6%. However, the Company's gross profit margin decreased to 8.0% in 2004 from 15.7% in 2003, as a result of the Company reducing prices to obtain a higher market share for its products.

There were several reasons for the decrease in gross margin. Most significantly, motherboard technology has improved significantly in the past year, leading to higher wholesale prices for such products. In future periods, the Company expects to be able to pass along the price increases to its customers. However, during the six months ended June 30, 2004, the Company priced its products very aggressively as it introduced its products to new markets in Mexico and South America. In addition, the Company took a one-time inventory write-down of $139,977 during the six months ended June 30, 2004 as it liquidated its old inventory.

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The higher quality of new motherboards has led to significant decreases in product returns and in price protection offered by the Company to its customers, which has reduced our selling and marketing expenses. However, that increase was more than offset by very high professional and audit fees relating to the audit of the Company's 2003 financial statements, which increased the Company's general and administrative expenses. The increased professional and audit fees were a direct result of the problems that the Company experienced with its internal controls and accounting systems. In an attempt to rectify the problem, the Company hired a new controller in May 2004. The increased level of professional and audit fees is not expected to continue during the remainder of 2004.

As of June 30, 2004, the Company has negative cash flows from its operations. The Company does not have any external sources of liquidity, other than advances from an officer, director and major shareholder and loans from LGT Computer, Inc.

Since October 24, 2002, the date that Soyo Nevada became a wholly-owned subsidiary of VWHC, Soyo has attempted to implement various measures designed to improve its operating results, cash flows and financial position, including the following:

- The Company has reviewed its product mix, and has revised its sales plan to focus on higher margin products.

- The Company is attempting to expand the number and credit quality of its customer accounts.

- The Company is attempting to arrange additional supply sources and to reduce its reliance on inventory purchases from Soyo Taiwan.

- The Company moved its office and warehouse operations into a larger, more efficient facility in September 2003.

- The Company is attempting to increase its operating liquidity by retaining advisors to explore the availability of outside debt and equity financing, to the extent such funding is available under reasonable terms and conditions.

There can be no assurances that these measures will result in an improvement in the Company's operations or liquidity. To the extent that the Company's operations and liquidity do not improve, the Company may be forced to reduce operations to a level consistent with its available working capital resources. The Company may also have to consider a formal or informal restructuring or reorganization.

As a result of these factors, the Company's independent accountants have included an explanatory paragraph in their report on the Company's 2003 consolidated financial statements indicating that there is substantial doubt about the Company's ability to continue as a going concern. The accompanying consolidated financial statements have been prepared assuming that the Company

will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The carrying amounts of assets and liabilities presented in the consolidated financial statements do not purport to represent the realizable or settlement values, and do not include any adjustments that might result from the outcome of this uncertainty.

Critical Accounting Policies:

The Company prepared its condensed consolidated financial statements in accordance with United States generally accepted accounting principles. The preparation of these financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Management periodically evaluates the estimates and judgments made. Management bases its estimates and judgments on historical experience and on various factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates as a result of different assumptions or conditions.

The Company operates in a highly competitive industry subject to aggressive pricing practices, pressures on gross margins, frequent introductions of new products, rapid technological advances, continual improvement in product price/performance characteristics, and changing consumer demand.

As a result of the dynamic nature of the business, it is possible that the Company's estimates with respect to the realizability of inventories and accounts receivable may be materially different from actual amounts. These differences could result in higher than expected allowance for bad debts or inventory reserve costs, which could have a materially adverse effect on the Company's financial position and results of operations.

The following critical accounting policies affect the more significant judgments and estimates used in the preparation of the Company's condensed consolidated financial statements.

Vendor Programs:

Funds received from vendors for price protection, product rebates, marketing and training, product returns and promotion programs are generally recorded as adjustments to product costs, revenue or sales and marketing expenses according to the nature of the program. The Company records estimated reductions to revenues for incentive offerings and promotions. Depending on market conditions, the Company may implement actions to increase customer incentive offerings, which may result in an incremental reduction of revenue at the time the incentive is offered.

Accounts Receivable:

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is probable.

The Company records estimated reductions to revenue for incentive offerings and promotions. Depending on market conditions, the Company may implement actions to increase customer incentive offerings, which may result in an incremental reduction of revenue at the time the incentive is offered.

In order to determine the value of the Company's accounts receivable, the Company records a provision for doubtful accounts to cover probable credit losses. Management reviews and adjusts this allowance periodically based on historical experience and its evaluation of the collectibility of outstanding accounts receivable. Accordingly, the Company established a provision for doubtful accounts of $1,052,720 and $856,386 at June 30, 2004 and December 31, 2003, respectively, which the Company believes is adequate based on its review and analysis of aged accounts receivable.

Inventories:

Inventories are stated at the lower of cost or market. Cost is determined by using the average cost method. The Company maintains a perpetual inventory system which provides for continuous updating of average costs. The Company evaluates the market value of its inventory components on a regular basis and reduces the computed average cost if it exceeds the component's market value. Inventories consist primarily of computer parts and components purchased from Soyo Taiwan.

Income Taxes:

The Company records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. In the event the Company was to determine that it would be able to realize its deferred tax assets in the future in excess of its recorded amount, an adjustment to the deferred tax assets would be credited to operations in the period such determination was made. Likewise, should the Company determine that it would not be able to realize all or part of its deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to operations in the period such determination was made.

Restatement:

In conjunction with the audit of the Company's consolidated financial statements for the year ended December 31, 2003, the Company conducted a review of its 2003 interim financial statements. As a result of this review, the Company restated its results of operations for the three months ended March 31, 2003, June 30, 2003 and September 30, 2003, to reflect various adjustments, primarily to correct the intra-period allocation of net revenues and cost of revenues (see "ITEM 4. CONTROLS AND PROCEDURES"). The Company's restated results of operations for the three months and six months ended June 30, 2003 are summarized at Note 6 to the Condensed Consolidated Financial Statements.

Results of Operations:

Three Months Ended June 30, 2004 and 2003:

Net Revenues. Net revenues increased by $3,292,554 or 47.7%, to $10,194,388 in 2004, as compared to $6,901,834 in 2003. The increase in net revenues in 2004 as compared to 2003 was a result of the Company focusing on obtaining a higher market share by reducing prices, particularly in South America. The Company also liquidated slow-moving inventories to prevent a further decrease in value.

During the three months June 30, 2004 and 2003, the Company offered price protection to certain customers under specific programs aggregating $70,959 and $605,746, respectively, which reduced net revenues and accounts receivable accordingly.

Gross Margin. Gross margin was $398,972 or 3.9% in 2004, as compared to $1,410,174 or 20.4% in 2003. There were several reasons for the decrease in gross margin. Most significantly, motherboard technology has improved significantly in the past year, leading to higher wholesale prices for such products. In future periods, the Company expects to be able to pass along the price increases to its customers. However, during the six months ended June 30, 2004, the Company priced its products very aggressively as it introduced its products to new markets in Mexico and South America. In addition, the Company took an inventory write-down of $6,314 during the three months ended June 30, 2004 as it liquidated its old inventory.

Sales and Marketing Expenses. Selling and marketing expenses increased by $7,649 or 3.0%, to $262,136 in 2004, as compared to $254,487 in 2003. Co-operative marketing program expense was $35,826 and $286,824 in 2004 and 2003, respectively.

General and Administrative Expenses. General and administrative expenses increased by $41,729 or 4.2%, to $1,027,198 in 2004, as compared to $985,469 in 2003. With regard to changes in operating expenses in 2004 as compared to 2003, the higher quality of new motherboards has led to significant decreases in product returns and in price protection offered by the Company to its customers, which has reduced our selling and marketing expenses. However, that increase was more than offset by very high professional and audit fees relating to the audit of the Company's 2003 financial statements, which increased the Company's general and administrative expenses. The increased professional and audit fees were a direct result of the problems that the Company experienced with its internal controls and accounting systems. In an attempt to rectify the problem, the Company hired a new controller in May 2004. The increased level of professional and audit fees is not expected to continue during the remainder of 2004.

Provision for Doubtful Accounts. The Company recorded a provision for doubtful accounts of $29,462 for the three months ended June 30, 2004. The Company did not record a provision for doubtful accounts for the three months ended June 30, 2003.

Depreciation and Amortization. Depreciation and amortization of property and equipment was $4,212 in 2004, as compared to $4,039 in 2003.

Income (Loss) from Operations. Loss from operations was $924,036 for the three months ended June 30, 2004, as compared to income from operations of $166,179 for the three months ended June 30, 2003, primarily as a result of the decrease in gross profit margin as described above at "Gross Margin".

Interest Income. Interest income was $25,219 in 2003. There was no interest income in 2004.

Interest Expense. Interest expense was $4,745 for the three months ended June 30, 2004 as compared to $10,026 for the three months ended June 30, 2003, reflecting interest on the Company's revolving note payable in 2003.

Provision for Income Taxes. The provision for income taxes was $28,750 in 2003. There was no provision for income taxes in 2004.

Net Income (Loss). The Company incurred a loss of $928,781 for the three months ended June 30, 2004, as compared to net income of $152,622 for the three months ended June 30, 2003, primarily as a result of the decrease in gross profit margin as described above at "Gross Margin".

Dividends on Class B Convertible Preferred Stock. The Company recorded aggregate dividends of $71,773 for the three months ended June 30, 2004, consisting of dividends of $37,500 and the accretion of the discount of $34,273.

Net Income (Loss) Available to Common Shareholders. The Company incurred a loss of $1,000,554 for the three months ended June 30, 2004, as compared to net income of $152,622 for the three months ended June 30, 2003, primarily as a result of the decrease in gross profit margin as described above at "Gross Margin".

Six Months Ended June 30, 2004 and 2003:

Net Revenues. Net revenues increased by $2,389,291 or 14.6%, to $18,788,690 in 2004, as compared to $16,399,399 in 2003. The increase in net revenues in 2004 as compared to 2003 was a result of the Company focusing on obtaining a higher market share by reducing prices, particularly in South America. The Company also liquidated slow-moving inventories to prevent a further decrease in value.

21

During the six months June 30, 2004 and 2003, the Company offered price protection to certain customers under specific programs aggregating $74,589 and $1,473,000, respectively, which reduced net revenues and accounts receivable accordingly.

Gross Margin. Gross margin was $1,512,140 or 8.0% in 2004, as compared to $2,581,040 or 15.7% in 2003. There were several reasons for the decrease in gross margin. Most significantly, motherboard technology has improved significantly in the past year, leading to higher wholesale prices for such products. In future periods, the Company expects to be able to pass along the price increases to its customers. However, during the six months ended June 30, 2004, the Company priced its products very aggressively as it introduced its products to new markets in Mexico and South America. In addition, the Company took a one-time inventory write-down of $139,977 during the six months ended June 30, 2004 as it liquidated its old inventory. During the six months ended June 30, 2003, the Company recorded an inventory write-down of $30,000.

Sales and Marketing Expenses. Selling and marketing expenses decreased by $174,145 OR 36.8%, to $299,288 in 2004, as compared to $473,433 in 2003, reflecting in part reduced vendor support programs funded by the Company. Co-operative marketing program expense was $82,266 and $418,206 in 2004 and 2003, respectively.

General and Administrative Expenses. General and administrative expenses increased by $44,072 or 2.5%, to $1,837,581 in 2004, as compared to $1,793,509 in 2003. With regard to changes in operating expenses in 2004 as compared to 2003, the higher quality of new motherboards has led to significant decreases in product returns and in price protection offered by the Company to its customers, which has reduced our selling and marketing expenses. However, that increase was more than offset by very high professional and audit fees relating to the audit of the Company's 2003 financial statements, which increased the Company's general and administrative expenses. The increased professional and audit fees were a direct result of the problems that the Company experienced with its internal controls and accounting systems. In an attempt to rectify the problem, the Company hired a new controller in May 2004. The increased level of professional and audit fees is not expected to continue during the remainder of 2004.

Provision for Doubtful Accounts. The Company recorded a provision for doubtful accounts of $196,335 for the six months ended June 30, 2004. The Company did not record a provision for doubtful accounts for the six months ended June 30, 2003.

Depreciation and Amortization. Depreciation and amortization of property and equipment was $8,267 in 2004, as compared to $8,074 in 2003.

Income (Loss) from Operations. Loss from operations was $829,331 for the six months ended June 30, 2004, as compared to income from operations of $306,024 for the six months ended June 30, 2003, primarily as a result of the decrease in gross profit margin as described above at "Gross Margin".

Interest Income. Interest income was $25,224 in 2003. There was no interest income in 2004.

Interest Expense. Interest expense was $4,745 for the six months ended June 30, 2004, as compared to $19,425 for the six months ended June 30, 2003, reflecting interest on the Company's revolving note payable in 2003.

Provision for Income Taxes. The provision for income taxes was $65,000 in 2003. There was no provision for income taxes in 2004.

Net Income (Loss). The Company incurred a loss of $834,076 for the six months ended June 30, 2004, as compared to net income of $246,823 for the six months ended June 30, 2003, primarily as a result of the decrease in gross profit margin as described above at "Gross Margin".

Dividends on Class B Convertible Preferred Stock. The Company recorded aggregate dividends of $71,773 for the six months ended June 30, 2004, consisting of dividends of $37,500 and the accretion of the discount of $34,273.

Net Income (Loss) Available to Common Shareholders. The Company incurred a loss of $905,849 for the six months ended June 30, 2004, as compared to net income of $246,823 for the six months ended June 30, 2003, primarily as a result of the decrease in gross profit margin as described above at "Gross Margin".

Financial Condition - June 30, 2004:

Liquidity and Capital Resources:

Transactions with Soyo Taiwan. Since the formation of Soyo Nevada in October 1998, the Company has relied on the financial support from Soyo Taiwan for inventory and capital to provide the resources necessary to conduct operations. Through October 24, 2002, Soyo Nevada was a wholly-owned subsidiary of Soyo Taiwan. Subsequent to that date, Soyo Taiwan continues to provide inventory to Soyo, and has agreed to continue to provide inventory to Soyo on an open account basis through December 31, 2005.

In conjunction with October 2002 transaction, Soyo Nevada transferred $12,000,000 of accounts payable to Soyo Taiwan to long-term payable, without interest, due December 31, 2005. Soyo Taiwan also agreed to continue to provide computer parts and components to Soyo on an open account basis at the quantities required and on a timely basis to enable Soyo to continue to conduct its business operations at budgeted levels, which is not less than a level consistent with the operations of Soyo Nevada's business in 2001 and 2000. This supply commitment is effective through December 31, 2005.

During the three months ended June 30, 2004 and 2003, the Company purchased inventory from Soyo Taiwan aggregating $6,548,225 and $867,742, respectively. During the six months ended June 30, 2004 and 2003, the Company purchased inventory from Soyo Taiwan aggregating $11,031,169 and $6,835,113, respectively. At June 30, 2004, the Company had short-term accounts payable to Soyo Taiwan of $5,485,436. At December 31, 2003, the Company had short-term accounts payable to Soyo Taiwan of $6,557,253 and a long-term payable to Soyo Taiwan of $12,000,000.

During the three months and six months ended June 30, 2003, the Company received price protection from Soyo Taiwan aggregating $343,415 and $435,415, respectively, which reduced inventories and accounts payable to Soyo Taiwan accordingly. The Company did not receive any price protection from Soyo Taiwan during the three months and six months ended June 30, 2004. The Company does not have any formal price protection agreement with Soyo Taiwan. The Company periodically negotiates price protection adjustments with Soyo Taiwan based on current market conditions.

As a result of the transaction described below which was effected during the six months ended June 30, 2004, $12,000,000 of long-term debt was converted into preferred equity, which resulted in a commensurate improvement in the Company's financial position and a substantial reduction in shareholder's deficiency at June 30, 2004 as compared to December 31, 2003.

Effective December 30, 2003, Soyo Taiwan entered into an agreement with an unrelated third party to sell the $12,000,000 long-term payable due it by the Company. As part of the agreement, Soyo Taiwan required that the purchaser would be limited to collecting a maximum of $1,630,000 of the $12,000,000 from the Company without the prior consent of Soyo Taiwan. In substance, Soyo Taiwan forgave debt in an amount equal to the difference between the $12,000,000 and the value of the preferred stock issued in settlement of this debt. This forgiveness of debt was treated as a capital transaction. Payment from the third

party was received by Soyo Taiwan in February and March 2004. An agreement was reached during the three months ended March 31, 2004 whereby 2,500,000 shares of Class B preferred stock would be issued by the Company to the unrelated third party in exchange for the long-term payable.

The Class B preferred stock has a stated liquidation value of $1.00 per share and a 6% dividend, payable quarterly in arrears, in the form of cash, additional shares of preferred stock, or common stock, at the option of the Company. The Class B preferred stock has no voting rights. The shares of Class B preferred stock are convertible, in increments of 100,000 shares, into shares of common stock based on the $1.00 stated value, at any time through December 31, 2008, based on the fair market value of the common stock, subject, however, to a minimum conversion price of $0.25 per share. No more than 500,000 shares of Class B preferred stock may be converted into common stock in any one year. On December 31, 2008, any unconverted shares of Class B preferred stock automatically convert into shares of common stock based on the fair market value of the common stock, subject, however, to a minimum conversion price of $0.25 per share. Beginning one year after issuance, upon ten days written notice, the Company or its designee will have the right to repurchase for cash any portion or all of the outstanding shares of Class B preferred stock at 80% of the liquidation value ($0.80 per share). During such notice period, the holder of the preferred stock will have the continuing right to convert any such preferred shares pursuant to which written notice has been received into common stock without regard to the conversion limitation. The Class B preferred stock has unlimited piggy-back registration rights, and is non-transferrable.

The Company recorded the issuance of the Class B preferred stock at its fair market value on March 31, 2004 of $1,304,000, which was determined by an independent investment banking firm. The $10,696,000 difference between the $12,000,000 long-term payable and the $1,304,000 fair market value of the Class B preferred stock was credited to additional paid-in capital. The difference between the fair market value and the liquidation value of the Class B preferred stock is being recognized as an additional dividend to the Class B preferred stockholder, and as a reduction to earnings available to common stockholders, and is being accreted from April 1, 2004 through December 31, 2008.

Going Concern. The Company is implementing various measures to attempt to improve its operations and liquidity as described above at "Financial Outlook". To the extent that the Company's operations and liquidity does not improve, the Company may be forced to reduce operations to a level consistent with its available working capital resources. The Company may also have to consider a formal or informal restructuring or reorganization.

As a result of these factors, the Company's independent accountants have included an explanatory paragraph in their report on the Company's 2003 consolidated financial statements indicating that there is substantial doubt about the Company's ability to continue as a going concern. The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The carrying amounts of assets and liabilities presented in the consolidated financial statements do not purport to represent the realizable or settlement values, and do not include any adjustments that might result from the outcome of this uncertainty.

Operating Activities. The Company utilized cash of $1,165,709 in operating activities during the six months ended June 30, 2004, as compared to $784,633 in operating activities during the six months ended June 30, 2003.

At June 30, 2004, the Company had cash and cash equivalents of $524,116, as compared to $717,196 at December 31, 2003.

The Company had a working capital deficiency of $1,143,715 at June 30, 2004, as compared to a working capital deficiency of $203,213 at December 31, 2003, resulting in current ratios of .92:1 and .98:1 at June 30, 2004 and December 31, 2003, respectively.

Net accounts receivable decreased to $6,095,636 at June 30, 2004, as compared to $6,818,729 at December 31, 2003, a decrease of $723,093 or 10.6%. The Company recorded a provision for doubtful accounts of $196,335 for the six months ended June 30, 2004. The Company did not record a provision for doubtful accounts for the six months ended June 30, 2003.

Inventories increased to $6,897,974 at June 30, 2004, as compared to $5,036,125 at December 31, 2003, an increase of $1,861,849 or 37.0% as a result of increased inventory purchases during the six months ended June 30, 2004. At June 30, 2004 and December 31, 2003, $3,752,122 and $3,426,342 of such inventories had been purchased from Soyo Taiwan.

Accounts payable - Soyo Computer, Inc. decreased to $5,485,436 at June 30, 2004, as compared to $6,557,253 at December 31, 2003, a decrease of $1,071,817 or 16.3%, as a result of payments on account exceeding new inventory purchases during 2004.

Accounts payable - other increased to $7,080,344 at June 30, 2004, as compared to $5,475,999 at December 31, 2003, an increase of $1,604,345 or 29.3%, as a result of increased inventory purchases from other suppliers.

Accrued liabilities increased to $825,718 at June 30, 2004, as compared to $592,984 at December 31, 2003, an increase of $232,734 or 39.2%, as a result of increased accruals with respect to professional fees, insurance and personnel-related costs.

Investing Activities. The Company expended $119,694 in 2004 for leasehold improvements with respect to the Company's new office and warehouse facility. The Company did not have any additions to property and equipment in 2003.

Financing Activities. During March 2003, Nancy Chu, the Company's Chief Financial Officer, director and major shareholder, made short-term advances to the Company of $360,000 for working capital purposes. The Company repaid $197,000 of its revolving note payable during June 2003.

During the six months ended June 30, 2004, the Company received a loan of $178,573, which has been recorded as an advance from Ms. Chu. These loans are non-interest bearing and due on demand.

On March 29, 2004, LGT Computer, Inc. loaned the Company $213,750 pursuant to an unsecured note payable due March 28, 2005, with interest at 4% per annum. On May 29, 2004, LGT Computer, Inc. loaned the Company an additional $700,000 pursuant to an unsecured note payable due May 29, 2005, with interest at 4% per annum. The principal stockholder and officer of LGT Computer, Inc. is an employee of the Company.

Principal Commitments:

A summary of the Company's contractual cash obligations as of June 30, 2004 is as follows:

		Payments Due By Period			
Contractual Cash Obligations	Total	Less than 1 year	Between 2-3 years	Between 4-5 years	After 5 years
Operating leases	$ 917,830	$ 197,969	$ 418,548	$ 301,313	$ --
Note payable	913,750	913,750	--	--	--
Advances from officer, director and major shareholder	418,573	418,573	--	--	--
Total contractual cash obligations	$2,250,153	$1,530,292	$ 418,548	$ 301,313	$ --

Off-Balance Sheet Arrangements:

At June 30, 2004, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

Commitments and Contingencies:

At June 30, 2004, the Company did not have any material commitments for capital expenditures.

Recent Accounting Pronouncements:

In August 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"). SFAS No. 143 addresses the diverse accounting practices for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company adopted SFAS No. 143 effective January 1, 2003. The adoption of SFAS No. 143 did not have a significant effect on the Company's financial statement presentation or disclosures.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. While SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of", it retains many of the fundamental provisions of that statement. The Company adopted SFAS No. 144 effective January 1, 2002. The adoption of SFAS No. 144 did not have a significant effect on the Company's financial statement presentation or disclosures.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections". SFAS No. 145 rescinds SFAS 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. Upon adoption of SFAS No. 145, the Company will be required to apply the criteria in APB Opinion No. 30, "Reporting the Results of Operations-- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" (Opinion No. 30), in determining the classification of gains and losses resulting from the extinguishment of debt. Additionally, SFAS No. 145 amends SFAS No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions to be accounted for in the same manner as sale-leaseback transactions. The Company adopted SFAS No. 145 effective January 1, 2003. The adoption of SFAS No. 145 for long-lived assets held for use did not have a significant effect on the Company's financial statement presentation or disclosures.

26

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit and Disposal Activities". SFAS No. 146 nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". Under EITF Issue No. 94-3, a liability for an exit cost is recognized at the date of an entity's commitment to an exit plan. Under SFAS No. 146, the liabilities associated with an exit or disposal activity will be measured at fair value and recognized when the liability is incurred and meets the definition of a liability in the FASB's conceptual framework. SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002. The adoption of SFAS 146 did not have a significant effect on the Company's financial statement presentation or disclosures.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation--Transition and Disclosure--an amendment of SFAS No. 123". SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure requirements of SFAS No. 123 and APB Opinion No. 28, "Interim Financial Reporting", to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company implemented SFAS No. 148 effective December 31, 2002. The Company has determined that it will continue to account for stock-based employee compensation in accordance with APB No. 25.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies under what circumstances a contract with initial investments meets the characteristics of a derivative and when a derivative contains a financing component. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003. The adoption of SFAS No. 149 did not have a significant effect on the Company's financial statement presentation or disclosures.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS No. 150 establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. SFAS No. 150 is to be implemented by reporting the cumulative effect of a change in accounting principle for financial instruments created before the issuance date of SFAS No. 150 and still existing at the beginning of the interim period of adoption. Restatement is not permitted. The adoption of SFAS No. 150 did not have a significant effect on the Company's financial statement presentation or disclosures.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others" ("FIN 45"), an interpretation of FASB Statements Nos. 5, 57 and 107 and a rescission of FASB Interpretation No. 34. FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. FIN 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of FIN 45 are applicable to guarantees

issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for financial statements of interim and annual periods ended after December 15, 2002. The adoption of FIN 45 did not have a significant effect on the Company's financial statement presentation or disclosures.

In November 2002, the FASB's Emerging Issues Task Force ("EITF") issued EITF No. 00-21 "Revenue Arrangements with Multiple Deliverables". EITF No. 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Specifically, EITF No. 00-21 addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. In applying EITF No. 00-21, separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and should, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary. EITF No. 00-21 also addresses how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. The guidance in EITF No.

00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company adopted EITF No. 00-21 effective July 1, 2003. The adoption of EITF No. 00-21 did not have a significant effect on the Company's financial statement presentation or disclosures.

In February 2003, the Financial Accounting Standards Board issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), which addresses the consolidation by business enterprises of variable interest entities, which have one or both of the following characteristics: (1) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional financial support from other parties, or (2) the equity investors lack one or more of the following essential characteristics of a controlling financial interest: (a) the direct or indirect ability to make decisions about the entity's activities through voting or similar rights, (b) the obligation to absorb the expected losses of the entity if they occur, or (c) the right to receive the expected residual returns of the entity if they occur. In addition, FIN 46 contains detailed disclosure requirements. FIN 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period ending after March 15, 2004, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. Early adoption is permitted. The Company adopted FIN 46 as of December 31, 2003. The adoption of FIN 46 did not have a significant effect on the Company's financial statement presentation or disclosures.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company does not have any market risk with respect to such factors as commodity prices, equity prices, and other market changes that affect market risk sensitive investments.

As the Company's debt obligations at June 30, 2004 are primarily short-term in nature and non-interest bearing, the Company does not have any risk from an increase in interest rates. However, to the extent that the Company arranges new interest-bearing borrowings in the future, an increase in current interest rates would cause a commensurate increase in the interest expense related to such borrowings.

The Company does not have any foreign currency risk, as its revenues and expenses, as well as its debt obligations, are denominated and settled in United States dollars.

28

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures:

In conjunction with the audit of the Company's financial statements for the year ended December 31, 2003, the Company's Chief Executive Officer and its Chief Financial Officer reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)), which are designed to ensure that material information the Company must disclose in its reports filed or submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported on a timely basis, and have concluded, based on that evaluation, that as of such date, the Company's disclosure controls and procedures were not adequate. In addition, the Company's automated financial reporting systems are overly complex, poorly integrated and inconsistently implemented. The Company estimates that it may take several months to rectify this situation.

The Company's Chief Executive Officer and Chief Financial Officer arrived at this conclusion based on a number of factors, including that the Company's system of internal control did not: (1) properly record accounts payable to vendors for purchases of inventory, (2) did not properly record adjustments to inventory per the general ledger to physical inventory balances, (3) did not properly record inventory adjustments to the lower of cost or market using the average inventory method, (4) did not periodically reconcile the Company's main bank account, (5) did not have adequate controls over interim physical inventory procedures, and (6) did not generate timely and accurate financial information to allow for the preparation of timely and complete financial statements. The Company does not have an adequate financial reporting process because of the aforementioned material weaknesses, including the difficulty in identifying and assembling all relevant contemporaneous documentation for ongoing business transactions; significant turnover in the Company's financial staff. Accordingly, the Company's Chief Executive Officer and Chief Financial Officer concluded that there were significant deficiencies, including material weaknesses, in the Company's internal controls over its financial reporting at the end of the fiscal period covered by this report.

The Company has experienced a substantial turnover in finance personnel. The Company's finance operations continue to be understaffed and its personnel lack comprehensive accounting policies and procedures to follow. In addition, the Company's personnel need to be further trained with respect to procedures and systems. The Company has hired a new controller and currently is seeking to hire additional personnel to focus on financial accounting and reporting issues.

Every quarter, the Company's controller supervises the reconciliation of the accounts payable subsidiary ledgers with the general ledger, approves adjustments to inventory based on reconciliation of the general ledger to physical inventory counts, and records inventory adjustments to the lower of cost or market.

Every month, the controller reconciles the bank accounts and compares the bank reconciliation with the balance per general ledger and the daily cash report, reviews the recording of accounts payable to vendors for purchases of inventory, and prepares financial statements with a complete set of adjustments.

During the three months ended June 30, 2004, the Company implemented a cycle count of its inventory, with the fifty fastest-moving items of "Type A" inventory physically counted and reconciled every morning with the recorded quantities and amounts. All "Type A" inventory is physically counted and reconciled every Monday. A complete inventory is physically counted and reconciled at the end of every month.

The Chief Executive Office and the Chief Financial Officer have reviewed and evaluated the corrective actions listed above. Such officers believe that such corrective actions minimize the risk of material misstatement, but the

corrective actions continue to have significant deficiencies. The Company is currently evaluating new accounting software that will address the Company's automated financial reporting system requirements.

(b) Changes in internal control over financial reporting:

In light of the foregoing, management is taking the actions that it deems necessary to rectify the current deficiencies as described above.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

A list of exhibits required to be filed as part of this report is set forth in the Index to Exhibits, which immediately precedes such exhibits, and is incorporated herein by reference.

(b) Reports on Form 8-K

Three Months Ended June 30, 2004:

On July 28, 2004, the Company filed a Current Report on Form 8-K (as amended on August 10, 2004) to report that it terminated Grobstein, Horwath & Company LLP as the Company's independent registered public accounting firm effective July 23, 2004, and that it engaged Vasquez & Company LLP as the Company's new independent registered public accounting firm effective July 26, 2004.

31

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.

SOYO GROUP, INC.

(Registrant)

DATE: August 20, 2004 By: /s/ MING TUNG CHOK

Ming Tung Chok
President and Chief
Executive Officer

DATE: August 20, 2004 By: /s/ NANCY CHU

Nancy Chu
Chief Financial Officer

32

INDEX TO EXHIBITS

Exhibit Number	Description of Document
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Ming Tung Chok
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Nancy Chu
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - Ming Tung Chok and Nancy Chu

33