

Edgar Filing: SOYO GROUP INC - Form 10-Q

SOYO GROUP INC  
Form 10-Q  
May 16, 2005

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

FORM 10-Q

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

For the quarterly period ended March 31, 2005

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  No

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

As of May 15, 2005, the registrant had 40,530,000 shares of common stock issued and outstanding.

Documents incorporated by reference: None.

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SOYO GROUP, INC. AND SUBSIDIARY

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SIGNATURES

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	----- (Unaudited)	-----
ASSETS		
CURRENT		
Cash and cash equivalents	\$ 513,339	\$ 1,288,351
Accounts receivable, net of allowance for doubtful accounts of \$1,105,264 and \$1,074,550 at March 31, 2005 and December 31, 2004, respectively	2,638,847	2,076,882
Inventories, including \$0 and \$1,893,442 purchased from SOYO Computer, Inc. at March 31, 2005 and December 31, 2004, respectively	2,819,715	3,861,911
Prepaid expenses	28,919	25,416
Income tax refund receivable	47,000	47,000
	-----	-----
	6,047,820	7,300,560
	-----	-----
Property and equipment	188,491	245,153
Less: accumulated depreciation and amortization	(88,836)	(80,087)
	-----	-----
	99,655	165,066
	-----	-----
Deposits	18,971	34,811
	-----	-----
	\$ 6,116,446	\$ 7,500,437
	=====	=====

(continued)

SOYO Group, Inc. and Subsidiary  
Condensed Consolidated Balance Sheets (continued)

March 31, 2005	December 31, 2004
-----	-----
(Unaudited)	

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LIABILITIES

CURRENT

Accounts payable -		
SOYO Computer, Inc.	\$ 195,557	\$ 1,314,910
Other	7,472,781	8,259,762
Accrued liabilities	574,711	829,043
Advances from officer, director and major shareholder	180,000	240,000
Note payable	913,750	913,750
	-----	-----
	9,336,799	11,557,465
	-----	-----

NON-CURRENT

Long-term payable - SOYO Computer, Inc.	--	--
	-----	-----

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
2,653,408 shares of Class B		
Convertible Preferred Stock,		
\$1.00 per share stated		
liquidation value		
(\$2,500,000 aggregate		
liquidation value)	1,566,946	1,527,733
Common stock, \$0.001 par value		
Authorized - 75,000,000 shares		
Issued and outstanding -		
40,500,000 shares	40,500	40,000
Additional paid-in capital	11,654,500	11,155,000
Accumulated deficit	(16,433,299)	(16,780,761)
	-----	-----
	(3,170,353)	(4,057,028)
	-----	-----
	\$ 6,116,446	\$ 7,500,437
	=====	=====

See accompanying notes to condensed consolidated financial statements.

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	-----	-----
Net revenues	\$ 3,962,520	\$ 8,594,302
Cost of revenues, including inventories purchased from SOYO Computer, Inc. of \$0 and \$3,948,177 in 2005 and 2004, respectively	3,440,485	7,481,134
	-----	-----
Gross margin	522,035	1,113,168
	-----	-----
Costs and expenses:		
Sales and marketing	239,465	37,152
General and administrative	933,973	810,383
Provision for doubtful accounts	31,124	166,873
Depreciation and amortization	8,749	4,055
	-----	-----
Total costs and expenses	1,213,311	1,018,463
	-----	-----
Income from operations	(691,276)	94,705
	-----	-----
Other income (expense):		
Interest income	--	--
Interest expense	11,221	--
Miscellaneous revenue	1,089,172)	
	-----	-----
Other expense, net	1,077,951	--
	-----	-----
Income before provision for income taxes	386,675	94,705
	-----	-----
Provision for income taxes	--	--
	-----	-----
Net income	\$ 386,675	\$ 94,705
	=====	=====
Less: Dividends on Class B Convertible Preferred Stock	39,213	--
	-----	-----
Net Income attributable to Common Shareholders	\$ 347,462	\$ 94,705
	-----	-----
Net income per common share -		
Basic	\$ 0.01	\$ --
Diluted	\$ 0.01	\$ --
	-----	-----
Weighted average number of common shares outstanding -		
Basic	40,530,000	40,000,000
Diluted	44,748,149	46,666,667

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2005	2004
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 386,675	\$ 94,705
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	8,749	4,055
Provision for doubtful accounts	31,124	166,873
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(593,089)	(328,111)
Inventories	1,043,196	(1,065,366)
Prepaid expenses	(3,503)	(2,500)
Deposits	15,840	--
Increase (decrease) in:		
Accounts payable - SOYO Computer, Inc.	(1,119,353)	701,490
Accounts payable - other	(786,981)	(500,948)
Accrued liabilities	(254,332)	160,139
Income taxes payable	--	--
	(1,271,674)	(769,663)
<b>Net cash used in operating activities</b>	<b>(1,271,674)</b>	<b>(769,663)</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of property and equipment	--	(3,500)
Proceeds from sale of equipment	56,662	--
	56,662	(3,500)
<b>Net cash used in investing activities</b>	<b>56,662</b>	<b>(3,500)</b>

(continued)

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	Three Months Ended March 31,	
	2005	2004
	-----	-----
<b>FINANCING ACTIVITIES</b>		
Advances from officer, director and major shareholder	\$ (60,000)	\$ --
Proceeds from issuance of note payable	--	213,750
Proceeds from issuance of Common Stock	500,000	--
	-----	-----
Net cash provided by financing activities	440,000	213,750
	-----	-----
<b>CASH AND CASH EQUIVALENTS</b>		
Net decrease	(775,012)	(559,413)
At beginning of period	1,288,351	717,196
	-----	-----
At end of period	\$ 513,339	\$ 157,783
	=====	=====
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid for -		
Interest	\$ --	\$ --
Income taxes	\$ --	\$ --
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES</b>		
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
Non-Cash dividends	\$ 39,213	\$ --

See accompanying notes to condensed consolidated financial statements.

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## SOYO Group, Inc. and Subsidiary Notes to Condensed Consolidated Financial Statements (Unaudited) Three Months Ended March 31, 2005 and 2004

### 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".

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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.



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The condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles.

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 March 31, 2005, the results of operations for the three months ended March 31, 2005 and 2004, and cash flows for the three months ended March 31, 2005 and 2004. The condensed consolidated balance sheet as of December 31, 2004 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, 2004, as filed with the Securities and Exchange Commission.

The preparation of financial statements in conformity with United States general 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 ended March 31, 2005 is not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2005.

Business - The Company sells computer components and peripherals to distributors and retailers primarily in North, Central and South America.

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 March 31, 2005, 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 2,653,408 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 March 31, 2005, 4,248,149 shares of common stock were issuable upon conversion of the Class A Convertible Preferred Stock and the Class B Convertible Preferred Stock, consisting of 1,162,791 shares of common stock

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issuable upon conversion of the Class A Convertible Preferred Stock, based on the closing price of \$0.86 per common share at March 31, 2005, and 3,085,358 shares of common stock issuable upon conversion of the Class B Convertible Preferred Stock, based on the \$0.86 per share conversion price.

As of March 31, 2004, 16,666,667 shares of common stock were issuable upon conversion of the Class A Convertible Preferred Stock, based on the closing price of \$0.19 per common share during the three months ended March 31, 2004.

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 ended March 31, 2005 and 2004.

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.

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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 and \$60,000 was repaid during March 2005.

### 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. On March 28, 2005, by mutual agreement of the parties, the due date of the notes were extended one year at the same interest rate. The new due date of the first loan is March 28, 2006. The new due date of the second loan is May 29, 2006.

### 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 will be 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 March 31,	
	2005	2004
Revenues		
Distributors	\$ 2,821,181	\$ 5,713,801
Retailers	1,141,339	2,880,501
	\$ 3,962,520	\$ 8,594,302

During the three months ended March 31, 2005 and 2004, the Company offered price protection to certain customers under specific programs aggregating \$99,272 and \$3,636, 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 March 31, 2005 and 2004, the Company had two customers that accounted for revenues of \$1,673,160 and \$2,697,593, equivalent to 34.2% and 31.4% of net revenues, respectively. The two customers were E23 Inc. and RJD Computer Inc.

b. Geographic Segments

Financial information by geographic segments is summarized as follows:

	Three Months Ended March 31,	
	2005	2004
Revenues		
North America	\$ 1,560,833	\$ 6,315,640
Central and South America	280,623	2,310,889
Other locations	2,121,064	(32,227)

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\$ 3,962,520	\$ 8,594,302
=====	=====

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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 March 31, 2005 and December 31, 2004, and for the three months ended March 31, 2005 and 2004:

	March 31, 2005	December 31, 2004
	-----	-----
Accounts payable to SOYO Taiwan	\$ 195,557	\$ 1,314,910
Long-term payable to SOYO Taiwan	--	--

	Three Months Ended March 31,	
	-----	-----
	2005	2004
	-----	-----
Purchases from SOYO Taiwan	\$ --	\$ 4,482,944
Payments to SOYO Taiwan	873,050	5,345,067

During the three months ended March 31, 2005 and 2004, the Company did not receive any price protection from SOYO Taiwan.

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

Cautionary Statement Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995:

This Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2005 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 March 31, 2005 involve known and unknown risks,

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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.

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### Background and Overview:

Historically, the Company has sold computer components and peripherals to distributors and retailers primarily in North, Central and South America. The Company operated in one business segment. A substantial majority of the Company's products were purchased from SOYO Taiwan pursuant to an exclusive distribution agreement effective through December 31, 2005, and were 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 Taiwan and SOYO Nevada management currently own 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".

In 2004, the Company decided to make a significant change in the core offerings for sale. The emphasis switched from motherboards and hardware to peripherals, leading to a more diverse product offering. Also in 2004, the Company introduced its VoIP products. SOYO Group, Inc. is entering the LCD display market with the introduction of 17- and 19-inch LCD monitors which are expected to be available in Q2 of 2005.

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

Three Months Ended March 31,			
2005		2004	
Amount	%	Amount	%

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Revenues				
Distributors	\$2,821,181	71.2	\$6,441,864	75.0
Retailers	1,141,340	28.8	2,152,438	25.0
	\$3,962,520	100.0	\$8,594,302	100.0
	=====	=====	=====	=====

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

During the three months ended March 31, 2005 and 2004, the Company had two customers that accounted for revenues of \$1,673,160 and \$2,697,593, equivalent to 34.2% and 31.4% of net revenues, respectively. Those customers are E23, Inc., and RJD Computer, Inc.

Financial information by geographic segments is summarized as follows:

	Three Months Ended March 31,			
	2005		2004	
	Amount	%	Amount	%
Revenues				
North America	\$ 1,560,832	39.38	\$ 6,315,640	73.5
Central and South America	280,624	7.08	2,310,889	26.9
Other locations	2,121,064	53.54	(32,227)	(0.4)
	\$ 3,962,520	100.0	\$ 8,594,302	100.0
	=====	=====	=====	=====

Financial Outlook:

As of March 31, 2005, the Company is reliant upon the 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 a private lender.

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

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efficient facility in September 2003.

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

On March 28, 2005 the Company announced that an accredited investor, Ever-Green Technology (Hong Kong) Co., Ltd., purchased 500,000 unregistered shares of its common stock, \$0.001 par value per share (the "Shares") and common stock purchase warrants to purchase 100,000 shares of its common stock exercisable at \$1.50 per share at any time until March 22, 2008 (the "Warrants"). The total offering price was \$500,000, which was paid in cash.

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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. The equity financing deal closed during the first quarter of 2005 is expected to provide the Company with sufficient proceeds to operate the business at least through the end of 2005, as the Company continues to cut expenses and expand revenue streams.

### Critical Accounting Policies:

The Company prepared its condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. 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



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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.

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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.

### 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.

### Results of Operations:

Three Months Ended March 31, 2005 and 2004:

Net Revenues. Net revenues decreased by \$4,631,782, or 53.89%, to \$3,962,520 in 2005, as compared to \$8,594,302 in 2004. The decrease in net revenues in 2005 as compared to 2004 was a continuing result of the Company's changing its core sales offerings, reducing inventory, and focusing primarily on selling off older inventory and opening markets for the LCD products, which are expected to be available for sale in May 2005.

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During the three months March 31, 2005 and 2004, the Company offered price protection to certain customers under specific programs aggregating \$99,272 and \$3,636, respectively, which reduced net revenues and accounts receivable accordingly.

Gross Margin. Gross margin was \$522,035 or 13.17% in 2005, as compared to \$1,113,168 or 12.9% in 2004.

Sales and Marketing Expenses. Selling and marketing expenses increased by \$202,313 to \$239,465 in 2005, as compared to \$37,152 in 2004. The increase is due to the hiring of sales people in the LCD and VoIP divisions.

General and Administrative Expenses. General and administrative expenses increased by \$123,590 to \$933,973 in 2005, as compared to \$810,383 in 2004. The increase is also due to the hiring of sales people in the LCD and VoIP divisions.

Provision for Doubtful Accounts. The Company recorded a provision for doubtful accounts of \$31,124 for the three months ended March 31, 2005. The Company recorded a provision for doubtful accounts of \$166,873 for the three months ended March 31, 2004.

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Depreciation and Amortization. Depreciation and amortization of property and equipment was \$8,749 in 2005, as compared to \$4,055 in 2004. The increase is a result of the use of leasehold improvements provided by the landlord after the move from Fremont to Ontario, CA.

Income from Operations. The loss from operations was \$(929,050) for the three months ended March 31, 2005, as compared to income from operations of \$94,705 for the three months ended March 31, 2004. This is a direct result of the reduced sales during the quarter, leading to a very small contribution margin.

Miscellaneous Income. Miscellaneous income was \$1,089,172 for the three months ended March 31, 2005. There was no miscellaneous income in the three months ended March 31, 2004. During the three months ended March 31, 2005, the Company was able to reach a final resolution with a vendor over a dispute that had arisen. The Company had purchased \$10,663,206 of products from this vendor since 2002. The Company found that RMA requests on these products were unusually high, and customer and distributor returns were also above normal. During the quarter, SOYO resolved these problems with Customers and Distributors for the Vendor, and the Company and the Vendor reached an agreement whereby the Company's payable of \$1,106,781 to the Vendor was cancelled.

Interest Income. There was no interest income in 2004 or in 2005.

Interest Expense. Interest expense was \$11,221 in 2005. There was no interest expense in 2004.

Provision for Income Taxes. There was no provision for income taxes in 2004 or in 2005.

Net Income. Net income was \$386,675 for the three months ended March 31, 2005, as compared to net income of \$94,705 for the three months ended March 31, 2004. This is a result of the misc. income referred to above. Without that, the Company would have suffered a substantial loss.

Financial Condition - March 31, 2004:

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### Liquidity and Capital Resources:

Transactions with SOYO Taiwan. Since the formation of SOYO Nevada in October 1998, through the end of 2004, the Company 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 continued to provide inventory to SOYO through 2004.

In conjunction with the 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 was to be effective through December 31, 2005.

During the three months ended March 31, 2005, the Company did not purchase inventory from SOYO Taiwan. During the three months ended March 31, 2004 the

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Company purchased \$4,482,944. At March 31, 2005, the Company had short-term accounts payable to SOYO Taiwan of \$195,557. At December 31, 2004, the Company had short-term accounts payable to SOYO Taiwan of \$1,314,910. At neither date were there any long-term payable to SOYO Taiwan.

During the three months ended March 31, 2004 and 2005, the Company did not receive any price protection from SOYO Taiwan. The Company does not have any formal price protection agreement with SOYO Taiwan.

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

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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-transferable.

The Company recorded the issuance of the Class B preferred stock at its fair market value on March 31, 2005 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 will be accreted from April 1, 2004 through December 31, 2008.

Operating Activities. The Company utilized cash of \$1,271,674 in operating activities during the three months ended March 31, 2005, as compared to \$769,663 in operating activities during the three months ended March 31, 2004.

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At March 31, 2005, the Company had cash and cash equivalents of \$513,339, as compared to \$1,288,351 at December 31, 2004.

The Company had a working capital deficiency of \$3,288,979 at March 31, 2005, as compared to a working capital deficiency of \$4,256,906 at December 31, 2004, resulting in current ratios of .65:1 and .63:1 at March 31, 2005 and December 31, 2004, respectively.

Accounts receivable increased to \$2,638,847 at March 31, 2005, as compared to \$2,076,882 at December 31, 2004, an increase of \$561,965 or 27.1%. The Company's provision for doubtful accounts stood at \$1,105,264 as of March 31, 2005, as compared to \$1,074,550 at March 31, 2004.

Inventories decreased to \$2,819,715 at March 31, 2005, as compared to \$3,862,911 at December 31, 2004, a decrease of \$1,043,196 or 27% as a result of decreased inventory purchases; during the three months ended March 31, 2005. During three months ending March 31, 2005, the company did not purchase any inventories from SOYO Taiwan.

Accounts payable - SOYO Computer, Inc. decreased to \$195,557 at March 31, 2005, as compared to \$1,314,910 at December 31, 2004, a decrease of \$1,119,353 or 85.1%, as a result of decreased inventory purchases.

Accounts payable - other decreased to \$7,358,177 at March 31, 2005, as compared to \$8,230,455 at December 31, 2004, a decrease of \$872,278 or 10.6%, as a result of reduced inventory purchases, and the forgiveness of debt by a supplier referenced on page 19.

Accrued liabilities decreased to \$574,711 at March 31, 2005, as compared to \$829,043 at December 31, 2004, a decrease of \$254,332 or 30.7%, as a result of decreased accruals with respect to interests, commissions and general costs.

Investing Activities. The Company received \$56,662 in 2005 for the purchase of property and equipment from the landlord in accordance with the terms of the new headquarters in Ontario, CA, as compared to spending \$3,500 in 2004 for the purchase of property and equipment.

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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, of which \$120,000 was repaid during September 2003 and \$60,000 was paid during March 2005.

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. On March 28, 2005, by mutual agreement of the parties, the due dates of both notes were extended one year at the same interest rate. The new due date of the first loan is March 28, 2006.

On March 28, 2005 the Company announced that an accredited investor, Ever-Green Technology (Hong Kong) Co., Ltd., purchased 500,000 unregistered shares of our common stock, \$0.001 par value per share (the "Shares") and common stock purchase warrants to purchase 100,000 shares of our common stock exercisable at \$1.50 per share at any time until March 22, 2008 (the "Warrants"). The total offering price was \$500,000, which was paid in cash.

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### Principal Commitments:

A summary of the Company's contractual cash obligations as of March 31, 2005 is as follows:

Contractual Cash Obligations	Total	Payments Due By Period			
		Less than 1 year	Between 1-2 years	Between 3-5 years	After 5 years
Operating leases	\$ 557,774	\$ 203,294	\$ 212,688	\$ 141,792	\$ --
Note payable	913,750	913,750	--	--	--
Advances from officer, director and major					
shareholder	180,000	180,000	--	--	--
Total contractual cash					
obligations	\$1,651,524	\$1,297,044	\$ 212,688	\$ 141,792	\$ --

### Off-Balance Sheet Arrangements:

At March 31, 2005, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

### Commitments and Contingencies:

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At March 31, 2005, the Company did not have any material commitments for capital expenditures.

### Recent Accounting Pronouncements:

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29". SFAS 153 addresses the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, Accounting for Nonmonetary Transactions, and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange.

The exception under APB 29 required that some nonmonetary exchanges, although commercially substantive, be recorded on a carryover basis. SFAS 153 eliminates the exception to fair value for exchanges of similar productive assets and replaces it with a general exception for exchange transactions that do not have commercial substance--that is, transactions that are not expected to result in significant changes in the cash flows of the reporting entity.

SFAS 153 is effective on January 1, 2006. The adoption of SFAS 153 is not expected to have an impact on the Company's consolidated financial statements or disclosures.

On December 16, 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," ("SFAS 123R") which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). Statement 123R supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and amends SFAS No. 95, "Statement of Cash Flows." Generally, the approach in SFAS 123R is similar to the approach described in SFAS 123. SFAS 123R requires all share-based payments to employees

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to be recognized in the income statement based on their grant date fair values over the corresponding service period and also requires an estimation of forfeitures when calculating compensation expense. The Company must adopt SFAS 123R no later than January 1, 2006. SFAS 123R permits public companies to adopt its requirements using one of three methods: the "modified prospective" method, the "modified retrospective" method to January 1, 2005, or the "modified retrospective" method to all prior years for which SFAS 123 was effective. The Company has not yet determined which adoption method it will utilize. The Company has not yet decided whether it will adopt the provisions of SFAS 123R on January 1, 2006 as required, or earlier, as allowed.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4." SFAS 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB 43, Chapter 4, previously stated that ". . . under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges. . . ." SFAS 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, SFAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities.

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SFAS 151 is effective on January 1, 2006. Earlier application is permitted for inventory costs incurred beginning January 1, 2005. The provisions of SFAS 151 shall be applied prospectively. The adoption of SFAS 151 is not expected to have an impact on the Company's consolidated financial statements 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.

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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 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.

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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

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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.

### 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 March 31, 2005 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.

### ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures:



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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'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 during 2003 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 between August 2003 and December 2003, (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 did 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, and significant turnover in the Company's financial staff. In addition to the

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foregoing, a former employee withheld information from the auditor during the 2003 audit. Accordingly, the Company's Chief Executive Officer realized 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 ended December 31, 2003.

In view of the fact that the financial information presented in the 2003 annual report was prepared in the absence of adequate internal controls over financial reporting, the Company devoted a significant amount of time and resources to the analysis of the financial information and documentation underlying the financial statements contained in this annual report, including the related interim financial statements, resulting in the restatement of certain interim financial statements. In particular, the Company reviewed all significant account balances and transactions underlying financial statements to verify the accuracy of the financial statements contained in the 2003 annual report.

When the Company's senior management realized that there were significant deficiencies, including material weaknesses, in our 2003 internal control over financial reporting, we retained outside advisors to assist the Company's financial staff in preparing the Company's financial statements, including the restated interim periods.

To address these weaknesses, the Company took the following corrective actions in 2004:

- o The Company hired a new Accounting Manager, then replaced the Accounting Manager with a more skilled professional. The Company

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retained an outside consultant to focus on financial accounting and reporting issues, then hired the Consultant onto the staff.

- o Each month, the Company's Accounting Manager supervises the reconciliation of the accounts payable subsidiary ledgers with the general ledger, and approves adjustments to inventory based on reconciliation of the general ledger to physical inventory counts. Each quarter, the Accounting Manager records inventory adjustments to the lower of cost or market.
- o 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 adjustments.
- o During the quarter ended September 30, 2004 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 reconciled every Monday.
- o A complete inventory is physically counted and reconciled at the end of every month.

In conjunction with the audit of the Company's financial statements for the year ended December 31, 2004, the Company's Chief Executive Officer and its Chief Financial Officer 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 continued to have significant deficiencies. The Company is currently evaluating new accounting software that it believes will address the Company's automated financial reporting system requirements. The Company expects the new accounting software to be in place and operational during the third quarter of fiscal year 2005.

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As of December 31, 2004, The Company's finance operations continued to be understaffed and its personnel lacked comprehensive accounting policies and procedures to follow. In addition, the Company's personnel need to be further trained with respect to procedures and systems. With the hiring of the new Accounting Manager and the Consultant, the Company believes it has finally addressed those areas and resolved the problem.

## PART II. OTHER INFORMATION

### ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

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. 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.

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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 shares of preferred stock were issued without registration in reliance upon the exemption afforded by Section 4(2) of the Securities Act of 1933, as amended, based on certain representations made to the Company by the recipient.

On March 28, 2005 the Company announced that an accredited investor, Ever-Green Technology (Hong Kong) Co., Ltd., purchased 500,000 unregistered shares of our common stock, \$0.001 par value per share (the "Shares") and common stock purchase warrants to purchase 100,000 shares of our common stock exercisable at \$1.50 per share at any time until March 22, 2008 (the "Warrants"). The total offering price was \$500,000, which was paid in cash.

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### 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 March 31, 2005:

The Company filed a Report on Form 8-K on March 22, 2005, detailing a sale of securities in a private placement to Ever-Green Technology Co. of Hong Kong, which is 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.

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SOYO GROUP, INC.

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(Registrant)

DATE: May 16, 2005

By: /s/ Ming Tung Chok

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President and Chief  
Executive Officer

DATE: May 16, 2005

By: /s/ Nancy Chu

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Nancy Chu  
Chief Financial Officer

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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

