SOYO GROUP INC
Form 10-Q
August 14, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the fiscal quarter ended June 30, 2006

[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE 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 91761-3646

(Address of Principal Executive Offices) (Zip Code)

(909) 292-2500

(Issuer's Telephone Number, Including Area Code)

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act: None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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). Yes [ ] No [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [X]

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

Indicate the number of shares outstanding of each of the Registrant's classes of Common Stock as of the latest practicable date.

As of August 14, 2006, there were 48,987,511 shares Outstanding.

Documents Incorporated by Reference: None

SOYO GROUP, INC. AND SUBSIDIARY

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SOYO Group, Inc. and Subsidiary
Condensed Consolidated Balance Sheets

	June 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
CURRENT		
Cash and cash equivalents	$ 757,911	$ 828,294
Accounts receivable, net of allowance for doubtful accounts of $256,203 and $589,224 at June 30, 2006 and December 31, 2005, respectively	7,667,217	7,278,520
Inventories	3,888,100	7,991,030
Prepaid expenses	0	20,984
	12,313,228	16,118,828
Property and equipment	972,206	867,122
Less: accumulated depreciation and amortization	(167,870)	(115,480)
	804,336	751,642
Deposits	127,689	36,920

	$ 13,245,253	$ 16,907,390

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

	June 30, 2006 (Unaudited)	December 31, 2005
LIABILITIES		
CURRENT		
Accounts payable -	10,540,512	13,977,579
Accrued liabilities	266,876	1,287,108
Advances from officer, director and major shareholder	0	0
Note payable	100,000	165,000
	10,907,388	15,429,687
NON-CURRENT		
Long-term payable - SOYO Computer, Inc.	--	--
SHAREHOLDERS' EQUITY		
Preferred stock, $0.001 par value Authorized - 10,000,000 shares Issued and outstanding - 3,000,940 shares of Class B Convertible Preferred Stock, (2,788,948 shares in 2005) $1.00 per share stated liquidation value ($2,500,000 aggregate liquidation value)	1,804,940	1,702,486
Preferred Stock Backup Withholding	(115,735)	(84,999)
Common stock, $0.001 par value Authorized - 75,000,000 shares Issued and outstanding - 48,987,511 shares		

(48,681,511 in 2005)	48,988	48,682
Additional paid-in capital	17,604,332	17,225,738
Accumulated deficit	(17,004,660)	(17,414,204)
	2,337,865	1,477,703
	$ 13,245,253	$ 16,907,390

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended June 30,	
	2006	2005
Net revenues	$ 10,787,515	$ 8,494,311
Cost of revenues	8,480,762	7,739,439
Prior Year's Purchases Discounts	0	(300,000)
Gross margin	2,306,753	1,054,872
Costs and expenses:		
Sales and marketing	322,127	124,029
General and administrative	1,269,686	881,355
Provision for doubtful accounts	53,184	3,390
Depreciation and amortization	26,574	9,338
Total costs and expenses	1,671,571	1,018,112
Income from operations	635,182	36,760
Other income (expense):		
Interest income	3,360	--
Interest expense	(78,082)	(12,157)
Miscellaneous revenue	754	77,516
Other income (expense), net	(73,968)	65,359
Net income	$ 561,214	$ 102,119
Less: Dividends on Class B Convertible Preferred Stock	(52,598)	(42,458)
Net Income attributable to Common Shareholders	$ 508,616	$ 59,661
Net income per common share -		
Basic	$ 0.01	$ 0.00
Diluted	$ 0.01	$ 0.00

Weighted average number of common shares outstanding -		
Basic	48,987,511	40,000,000
Diluted	59,365,449	46,666,667

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

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Net revenues	$ 22,335,702	$ 12,456,830
Cost of revenues,	18,377,861	11,179,925
Prior Year's Purchase Discounts and Allowances	0	(1,300,000)
Gross margin	3,957,841	2,576,905
Costs and expenses:		
Sales and marketing	397,013	363,494
General and administrative	2,754,679	1,815,328
Provision for doubtful accounts	103,184	34,513
Depreciation and amortization	52,390	18,087
Total costs and expenses	3,307,266	2,231,422
Income from operations	650,575	345,483
Other income (expense):		
Interest income	6,607	--
Interest expense	(150,469)	(23,378)
Miscellaneous revenue	5,285	166,688
Other income (expense), net	(138,577)	143,310
Income before provision for income taxes	511,998	488,793
Provision for income taxes	--	--
Net income	$ 511,998	$ 488,793
Less: Dividends on Class B Convertible Preferred Stock	(102,454)	(81,671)
Net Income attributable to Common Shareholders	$ 409,544	$ 407,122
Net income per common share -		
Basic	$ 0.01	$ 0.01
Diluted	$ 0.01	$ 0.01

Weighted average number of common shares outstanding -		
Basic	48,987,511	44,408,200
Diluted	59,365,449	49,279,410

See accompanying notes to condensed consolidated financial statements.

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

	Six Months Ended June 30,	
	2006	2005
OPERATING ACTIVITIES		
Net income	$ 511,998	$ 488,793
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	52,390	18,087
Provision for doubtful accounts	103,184	34,513
Stock Based Compensation	271,560	--
Non cash payments for Director's compensation	24,570	--
Non cash payments for public Relations and promotion	82,770	--
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(491,881)	(3,239,016)
Inventories	4,102,930	896,489
Prepaid expenses	20,984	21,479
Deposits	(90,769)	15,840
Increase (decrease) in:		
Accounts Payable- SOYO Computer Inc.	--	(1,314,910)
Accounts payable-other	(3,437,067)	(997,692)
Accrued liabilities	(1,020,232)	(570,187)
Net cash provided by (used in) operating activities	130,437	(4,646,604)
INVESTING ACTIVITIES		
Purchase of property and equipment	(105,084)	(50,911)
Proceeds from sale of equipment	--	56,662
Net cash provided by (used in) investing activities	(105,084)	5,751

(continued)

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

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
FINANCING ACTIVITIES		
Advances from officer, director and major shareholder	$ (65,000)	$ (60,000)
Payment of backup withholding tax on accreted dividends on preferred stock	(30,736)	--
Proceeds from issuance of Common Stock	--	3,559,547
Net cash provided by (used in) financing activities	(95,736)	3,499,547
CASH AND CASH EQUIVALENTS		
Net decrease	(70,383)	(1,141,306)
At beginning of period	828,294	1,288,351
At end of period	$ 757,911	$ 147,045
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Accretion of dicount on preferred stock	102,454	$ 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, 2006 and 2005

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.

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.

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, 2006, the results of operations for the three and six months ended June 30, 2006 and 2005, and

cash flows for the six months ended June 30, 2006 and 2005. The condensed consolidated balance sheet as of December 31, 2005 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, 2005, 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 and six months ended June 30, 2006 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2006.

Business - The Company sells products under three different product lines: 1) Computer Components and Peripherals 2) Consumer Electronics and 3) Communications Equipment and Services. The products are sold 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 June 30, 2006, potentially dilutive securities consisted of 3,000,940 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, 2006, 9,377,938 shares of common stock were issuable upon conversion of the Class B Convertible Preferred Stock, based on the closing price of $0.32 per common share at June 30, 2006.

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 or six months ended June 30, 2006 and 2005.

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").

SFAS No. 123(R) requires that companies recognize all share-based payments to employees, including grants of employee stock options, in the financial statements. The cost will be based on the fair value of the equity or liability instruments issued and recognized over the respective vesting period of the stock option. Pro forma disclosure of this cost will no longer be an alternative under SFAS No. 123(R). SFAS 123(R) is effective for public companies at the beginning of the first fiscal year that begins after June 15, 2005.

Transition methods available to public companies include either the modified prospective or modified retrospective adoption. The modified prospective transition method requires that compensation cost be recognized beginning on the effective date, or date of adoption if earlier, for all share-based payments granted after the date of adoption and for all unvested awards existing on the date of adoption. The modified retrospective transition method, which includes the requirements of the modified prospective transition method, additionally requires the restatement of prior period financial information based on amounts previously recognized under SFAS No. 123 for purposes of pro-forma disclosures. The Company adopted SFAS No. 123(R) effective January 1, 2006. The Company adopted the modified prospective method. As a result, the Company recognized a charge against earnings of $256,524 for the six months ended June 30, 2006.

For further information, refer to note 4, stock based compensation on page 14. On March 7, 2005, the Company registered its 2005 Stock Compensation Plan on Form S-8 with the Securities and Exchange Commission, registering on behalf of our employees, officers, directors and advisors up to 5,000,000 shares of our common stock purchasable by them pursuant to common stock options granted under our 2005 Stock Compensation Plan. The plan was approved by shareholder vote during a special meeting of shareholders on February 17, 2006. However, since Mr. Chok and Ms. Chu, husband and wife, are directors who own more than 50% of the company, shareholder approval is essentially a formality, hence the grant date of the stock options is July 22, 2005.

On July 22, 2005, the Company issued 2,889,000 option grants to employees at a strike price of $.75. One third of those options will vest and be available for purchase on July 22, 2006, one third on July 22, 2007, and one third on July 22, 2008. The grants will expire if unused on July 22, 2010.

As of June 30, 2006, 9 employees who had been granted stock options had left the Company, and grants totaling 462,000 options were returned to the Company. As of June 30, 2006, the Company has not issued any option grants to employees other than the 2,889,000 option grants issued on July 22, 2005.

2. Short Term Loan

In October 2005, the Company borrowed $165,000 from an individual for working capital purposes. As of June 30, 2006, $65,000 of the loan had been repaid, and $100,000 is still outstanding.

3. 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.

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4. Stock-Based Compensation

Prior to January 1, 2006, the Company accounted for employee stock-based compensation using the intrinsic value method supplemented by pro forma disclosures in accordance with APB 25 and SFAS 123 "Accounting for Stock-Based Compensation" ("SFAS 123") Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at grant date or other measurement date over the amount an employee must pay to acquire the stock.

Effective January 1, 2006 the Company adopted SFAS 123R using the modified prospective approach and accordingly prior periods have not been restated to reflect the impact of SFAS 123R. Under SFAS 123R, stock-based awards granted prior to its adoption will be expensed over the remaining portion of their vesting period. These awards will be expensed under the straight line amortization method using the same fair value measurements which were used in calculating pro forma stock-based compensation expense under SFAS 123. For stock-based awards granted on or after January 1, 2006, the Company will amortize stock-based compensation expense on a straight-line basis over the requisite service period, which is generally a five-year vesting period.

SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. Stock-based compensation expense has been recorded net of estimated forfeitures for the period ended June 30, 2006 such that expense was recorded only for those stock-based awards that are expected to vest. Previously under APB 25 to the extent awards were forfeited prior to vesting, the corresponding previously recognized expense was reversed in the period of forfeiture.

The proforma disclosure as required by SFAS 148 is not necessary because the stock options were granted in July 2005. Therefore, there would have been no stock-based compensation recorded for the period ended June 30, 2005 using either the intrinsic value or fair value based method.

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,	
	2006	2005	2006	2005
Revenues				
Distributors	$ 9,273,290	$ 6,600,654	$ 16,848,648	$ 9,121,834
Retailers	963,656	2,146,678	4,546,697	3,588,017
Others	550,569	(253,021)	940,357	(253,021)
	$ 10,787,515	$ 8,494,311	$ 22,335,702	$ 12,456,830

During the three months ended June 30, 2006 and 2005, the Company offered price protection to certain customers under specific programs aggregating $25,078 and $7,142, 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, 2006, the Company had two customers that accounted for revenues of $1,141,120 and $2,205,201, equivalent to 10.6% and 20.4% of net revenues, respectively. The two customers were D & H Distributing, Inc., and SED International, Inc. Both companies are distributors who sell the Company's products to retailers in the United States.

b. Geographic Segments

Financial information by geographic segments is summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues				
United States	$ 8,019,132	$ 3,521,249	$17,323,011	$ 5,032,339
Canada	790,316	212,310	1,511,007	262,052
Central and South America	1,975,627	247,929	3,364,911	528,552
Other locations	2,440	4,512,823	136,773	6,633,887
	$10,787,515	$ 8,494,311	$22,335,702	$12,456,830

c. On June 30, 2006, the Company began calculating net revenue by product line for financial reporting purposes. 2006 sales by product line are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues				
Consumer Electronics	$10,237,351	NOT	$21,442,272	NOT
Computer Products	496,226	AVAILABLE	747,737	AVAILABLE
VOIP	53,938		145,693	
	$10,787,515		$22,335,702	

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d. Suppliers

Of the products the Company sold in 2005, no more than 39% of the products were produced by any one vendor. The Company is working to reduce that dependency and expects that no more than 20% of any products sold in 2006 will be produced by one vendor.

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 June 30, 2006 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, 2006 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:

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 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

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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. In 2005, SOYO Group, Inc. entered the LCD display market with the introduction of 17- and 19-inch LCD monitors, and 32 and 37 inch LCD televisions. Both products were introduced in the second quarter of 2005. Currently, the Company sells products under three different product lines: 1) Computer Components and Peripherals 2) Consumer Electronics and 3) Communications Equipment and Services. The products are sold to distributors and retailers primarily in North, Central and South America.

Financial Outlook:

As of June 30, 2006, the Company is reliant upon the cash flows from its operations. The Company does not have any external sources of liquidity, other than a company that advances funds to the Company against receivables, 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 changed its product mix substantially in the past two years, and has changed its sales plan to focus on higher margin products.

- The Company has expanded the number and credit quality of its customer accounts.

- The Company is negotiating with additional suppliers, but the ability to buy goods from those suppliers is reliant on cash flows.

- 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 exploring 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.

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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:

Firm agreements with 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. The Company records the corresponding effect in cost or expense at the time it has a firm agreement with a vendor.

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. The Company records the corresponding effect on receivable and revenue when the Company offers the incentive to customers. All accruals estimating sales incentives, warranties, rebates and returns are based on historical experience and the Company management's collective experience in anticipating customers actions. These amounts are reviewed and updated each month when financial statements are generated.

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Complicating these estimates is the Company's different return policies. The Company does not accept returns from customers for refunds, but does repair merchandise as needed. The cost of the shipping and repairs may be borne by the customer or the Company, depending on the amount of time that has passed since the sale and the product warranty.

The Company has different return policies with different customers. While the Company does not participate in "guaranteed sales" programs, the Company has begun to sell products to several national retail chains. Some of these chains have standard contracts which require the Company to accept returns for credit within standard return periods, usually sixty days. While these return policies are more generous than the Company usually offers, management has made the decision to accept the policies and sell the products to these national chains for both the business volume and exposure such sales generate. These sales have been taking place since late 2005, and returns have consistently been below management's expectations. Therefore, no adjustments to the financial statements have been necessary.

Each month, management reviews the accounts receivable aging report and adjusts the allowance for bad debts based on that review. The adjustment is made based on historical experience and management's evaluation of the collectibility of outstanding accounts receivable over 90 days. At all times, the allowance for bad debts is large enough to cover all receivables that management is not certain it will collect, plus another one percent of the net accounts receivable. At June 30, 2006, the allowance was $256,203. Since the net A/R balance was approximately $7.7 million, the amount the Company considered uncollectible was under $180,000.

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.

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.

Prior Year's Purchases and Discounts:

The company negotiated with its suppliers for discounts and allowances related to purchases made in 2004. The company and its suppliers settled their differences in 2005. The company accounted in 2005 for the settlement as a gain contingency, in accordance with FAS 5, Accounting for Contingencies.

The company also accounted in 2005 for its settlement with suppliers of discounts and allowances as a reduction of cost of goods sold because purchase discounts and allowances are of a "character typical of the customary business activities of the entity" in accordance with APB 9, as amended by APB 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.

Results of Operations:

Three Months Ended June 30, 2006 and 2005:

Net Revenues. Net revenues increased by $2,293,204 or 27.0%, to $10,787,515 in the three months ended June 30, 2006, as compared to $8,494,311 in 2005. The increase in the net revenues was due to the company's shift in product focus from our traditional motherboard business to a more diverse product base that includes Broadband VoIP, Computer Peripherals and Consumer Electronics. The Company began to sell the LCD products during the second quarter of 2005, and in

the past year has greatly expanded its distribution channel. The Company continues to sell products to new customers. Customers who bought products from the Company in the three months ended June 30, 2006 that had not previously purchased our products included The Home Depot, Target, Walmart.com, Sam's Club Canada, and RTO Distribution Inc., a large lessor of electronic products in Canada.

Gross Margin. Gross margin was $2,306,753 or 21.4% in 2006, as compared to $1,054,872 or 12.4% in 2005. The increase in the gross margin as a percentage of sales can be attributed entirely to the new product lines, and a couple of deals that were completed with extremely high gross margins. The Company believes that gross margins will stabilize around 16% in the future.

Sales and Marketing Expenses. Selling and marketing expenses increased by $198,098 to $322,127 in 2006, as compared to $124,029 in 2005. The increase is entirely due to the Company beginning to utilize outside sales reps. The commissions to the outside sales reps were the entire difference in sales and marketing expenses between the two quarters. The Company has been successful breaking into new markets and signing new customers because of the outside reps.

General and Administrative Expenses. General and administrative expenses increased by $388,331 to $1,269,686 in 2006, as compared to $881,355 in 2005. The increase can be explained by two factors.

On April 14, 2005 a lawsuit was filed in Superior Court of the State of California, County of San Bernardino, entitled Afshin Pourvajdi v. SOYO Group, Inc., Nancy Chu and various Doe defendants. Case RCV 086992. The complaint alleged causes of action for: 1) Double damages for violation of labor code Section 970; 2) Misrepresentation; 3) Intentional Infliction of Emotional Distress; 4) Breach of Contract. The prayer for relief in the Complaint sought damages of no less than $200,000 on the first and second causes of action, plus an unspecified amount of punitive damages and an unspecified amount of general and punitive damages on the third cause of action and an unspecified amount of general and punitive damages on the fourth cause of action. Plaintiff also sought to recover all costs and attorney fees. The case arose from a consultant who worked for the Company in 2004 and whose contract was not renewed. During the second quarter, the Company settled the case for $70,000, which it believed to be less than the cost of the upcoming trial. As a result, the entire settlement amount was accrued and expensed during the quarter, and the legal fees spent preparing for the case have been paid and expensed during the quarter as well.

The second factor in the increased G&A costs was the Company's mandatory implementation of SFAS No. 123(R). In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123(R)") which replaces SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123(R) requires that companies recognize all share-based payments to employees, including grants of employee stock options, in the financial statements. The cost will be based on the fair value of the equity or liability instruments issued and recognized over the respective vesting period of the stock option. Pro forma disclosure of this cost will no longer be an alternative under SFAS No. 123(R). SFAS 123(R) was effective for public companies at the beginning of the first fiscal year that begins after June 15, 2005.

The Company adopted SFAS No. 123(R) effective January 1, 2006. The Company adopted the modified prospective method. As a result, the Company recognized a

charge against earnings of $121,573 for the three months ended June 30, 2006.

Taken together, the lawsuit and the adoption of SFAS 123 accounted for approximately $192,000 of expenses that were not incurred in the three months ended June 30, 2005.

Provision for Doubtful Accounts. The Company recorded a provision for doubtful accounts of $53,184 in the three months ended June 30, 2006. The Company recorded a provision for doubtful accounts of $3,390 for the three months ended June 30, 2005. As of June 30, 2006, the Company believes its provision for doubtful accounts is adequate.

Depreciation and Amortization. Depreciation and amortization of property and equipment was $26,574 for the three months ended June 30, 2006, as compared to $9,338 in 2005. The increase is a result of the use of leasehold improvements provided by the landlord after the move from Fremont to Ontario, CA, and depreciable assets purchased in December 2005 in China for the VoIP business.

Income from Operations. The income from operations was $635,182 for the three months ended June 30, 2006, as compared to $36,760 for the three months ended June 30, 2005. This is a result of the improved sales volume and operating margins described above.

Miscellaneous Income. Miscellaneous income was $754 for the three months ended June 30, 2006. Miscellaneous income was $77,516 in the three months ended June 30, 2005.

Interest Income. Interest income was $3,360 for the three months ended June 30, 2006. There was no interest income in 2005.

Interest Expense. Interest expense was $78,082 for the three months ended June 30, 2006. Interest expense was $12,157 for the three months ended June 30, 2005. The increase was due to several factors. The Company has been aggressively borrowing funds on a short term basis as needed to support its growth. The Company is factoring all receivables to improve cash flow and has needed to provide Letters of Credit on different occasions to guarantee payment for goods. Both of these programs are extremely expensive, but were necessary to guarantee the uninterrupted flow of goods from our suppliers overseas. The lack of an open and ongoing credit facility has been the Company's biggest problem in managing growth. The establishment of such a facility is the Company's primary goal for 2006.

Provision for Income Taxes. There was no provision for income taxes in 2006 or in 2005.

Net Income. Net income was $561,214 for the three months ended June 30, 2006, as compared to $102,119 for the three months ended June 30, 2005.

Six Months Ended June 30, 2006 and 2005:

Net Revenues. Net revenues increased by $9,878,872 or 79.3%, to $22,335,702 in 2006, as compared to $12,456,830 in 2005. The large increase in the net revenues was due to the company's 2005 shift in product focus from our traditional motherboard business to a more diverse product base that includes Broadband VoIP, Computer Peripherals and Consumer Electronics. During the second quarter of 2005, the consumer electronics products were first received from suppliers and available for sale. Although the products sold well from the first day, the products were new, there was no publicity, and the products had not yet been

tested or written up by different publications. Now, a year later, all those steps have been taken, and the sales force has had a year to build the customer base. Sales during the quarter were made to over a dozen new customers, including The Home Depot, Target, Walmart.com, Sam's Club Canada, and RTO Distribution Inc., a large lessor of electronic products in Canada. The Company expects sales to continue to increase at a comparable rate through the end of the year, subject to supply interruptions.

Gross Margin. Gross margin was $3,957,841 or 17.7% for the six months ended in 2005, as compared to $2,576,905 or 20.7% in 2005. The decrease in the gross margin is distorted, as the 2005 number is a result of the settlement of a dispute with a vendor, resulting in large returns during the period that affected the gross margin. The Company believes that as the LCD market becomes more mature, gross margin is likely to stabilize in the 15-16% range.

Sales and Marketing Expenses. Selling and marketing expenses increased by $33,519 to $397,013 in 2006, as compared to $363,494 in 2005. The increase is due to outside sales reps that the Company has been using to develop the new customer base. This increase is offset by reduced travel and promotional expenses. It has been a full year that has passed since the Company introduced the new product line. A lot of start up expenses, travel and promotions that occurred for the product launch last year were not repeated in 2006.

General and Administrative Expenses. General and administrative expenses increased by $939,351 to $2,754,679 in 2006, as compared to $1,815,328 in 2005. The increase is primarily due to three factors.

First, the cost of the annual audit increased by approximately $75,000 over the prior year. The increase was primarily due to the Company's untimely loss of accounting personnel as described in Item 9A of report 10K dated December 31, 2005. The Company believes the problem has been solved, and expects that the cost of future audits will be in line with prior years.

Second, on April 14, 2005 a lawsuit was filed in Superior Court of the State of California, County of San Bernardino, entitled Afshin Pourvajdi v. SOYO Group, Inc., Nancy Chu and various Doe defendants. Case RCV 086992. The complaint alleged causes of action for: 1) Double damages for violation of labor code Section 970; 2) Misrepresentation; 3) Intentional Infliction of Emotional Distress; 4) Breach of Contract. The prayer for relief in the Complaint sought damages of no less than $200,000 on the first and second causes of action, plus an unspecified amount of punitive damages and an unspecified amount of general and punitive damages on the third cause of action and an unspecified amount of general and punitive damages on the fourth cause of action. Plaintiff also sought to recover all costs and attorney fees. The case arose from a consultant who worked for the Company in 2004 and whose contract was not renewed. During the second quarter, the Company settled the case for $70,000, which it believed to be less than the cost of the upcoming trial. As a result, the entire settlement amount was accrued and expensed during the quarter, and the legal fees spent preparing for the case have been paid and expensed during the period as well.

The biggest factor in the increased G&A costs was the Company's mandatory implementation of SFAS No. 123(R). In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123(R)") which replaces SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123(R) requires that companies recognize all share-based payments to employees, including grants of employee stock options, in the financial statements. The cost will be based on the fair value of the equity or

liability instruments issued and recognized over the respective vesting period of the stock option. Pro forma disclosure of this cost will no longer be an alternative under SFAS No. 123(R). SFAS 123(R) was effective for public companies at the beginning of the first fiscal year that begins after June 15, 2005.

The Company adopted SFAS No. 123(R) effective January 1, 2006. The Company adopted the modified prospective method. As a result, the Company recognized a charge against earnings of $134,952 for the three months ended March 31, 2006 and $121,573 for the three months ended June 30, 2006. The complete effect of the adoption was a non cash charge against earnings of approximately $257,000 over the six month period.

Provision for Doubtful Accounts. The Company recorded a provision for doubtful accounts of $103,184 for the six months ended June 30, 2006. The Company recorded a provision for doubtful accounts of $34,513 for the six months ended June 30, 2005.The increase in the provision is directly attributable to the large sales increase, and the Company's conservative approach. The Company believes that the provision for doubtful accounts is sufficient as of June 30, 2006.

Depreciation and Amortization. Depreciation and amortization of property and equipment was $52,390 for the six months ended June 30, 2006, as compared to $18,087 in 2005. The increase is a result of the use of leasehold improvements provided by the landlord after the move from Fremont to Ontario, CA, and the purchase of depreciable equipment in December 2005 in China for the VoIP business.

Income from Operations. The income from operations was $650,575 for the six months ended June, 2006, as compared to income from operations of $345,483 for the six months ended June 30, 2005. This is a direct result of the increased sales volumes and strong margins.

Miscellaneous Income. Miscellaneous income was $5,285 for the six months ended June 30, 2006, as opposed to $166,688 for the six months ended June 30, 2005.

Interest Income. Interest income was $6,607 for the six months ended June 30, 2006. There was no interest income in 2005.

Interest Expense. Interest expense was $150,469 for the six months ended June 30, 2006. Interest expense was $23,378 for the six months ended June 30, 2005. The increase was due to several factors. The Company has been aggressively borrowing funds on a short term basis as needed to support its growth. The Company is factoring all receivables to improve cash flow and has needed to provide Letters of Credit on different occasions to guarantee payment for goods. Both of these programs were necessary to guarantee the uninterrupted flow of goods from our suppliers overseas. The sale of all invoices is done with recourse, which means that if the factor is not paid, they can charge back the Company for the unpaid invoice plus interest. The lack of an open and ongoing credit facility to enhance and manage growth has been the Company's biggest challenge. The establishment of such a facility is the Company's primary goal for 2006.

Provision for Income Taxes. There was no provision for income taxes in 2006 or in 2005.

Net Income. Net income was $511,998 for the six months ended June 30, 2006, as compared to $488,793 for the six months ended June 30, 2005. The 2006 numbers include the charges for the adoption of SFAS 123R. Looking at the numbers on a comparable basis, the 2006 numbers are significantly better, which is a result of strong sales volume and strong operating margins.

Financial Condition - June 30, 2006:

Liquidity and Capital Resources:
As of June 30, 2006, 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.

Operating Activities. The Company generated cash of $130,437 in operating activities during the six months ended June 30, 2006, as compared to utilizing cash of $4,646,604 in operating activities during the six months ended June 30, 2005.

At June 30, 2006, the Company had cash and cash equivalents of $757,911, as compared to $828,294 at December 31, 2005.

The Company had working capital of $1,405,840 at June 30, 2006, as compared to working capital of $689,141 at December 31, 2005, resulting in current ratios of 1.13:1 and 1.04:1 at June 30, 2006 and December 31, 2005, respectively.

Accounts receivable increased to $7,667,217 at June 30, 2006, as compared to $7,278,520 at December 31, 2005, an increase of $388,697. The Company's provision for doubtful accounts stood at $256,203 as of June 30, 2006, as compared to $589,224 at December 31, 2005.

Inventories decreased to $3,888,100 at June 30, 2006, as compared to $7,991,030 at December 31, 2005, a decrease of $4,102,930 or 51%. The Company expects inventory levels to remain low until new products are offered for sale and the Company obtains outside financing. Currently, the Company does not have the liquidity to purchase large quantities of inventory.

Accounts payable decreased to $10,540,512 at June 30, 2006, as compared to $13,977,579 at December 31, 2005, a decrease of $3,437,067, as a direct result of reduced inventory purchases. The decrease in payables is comparable to the decrease in inventory levels as older purchases were paid for and newer purchase volumes declined.

Accrued liabilities decreased to $266,876 at June 30, 2006, as compared to $1,287,108 at December 31, 2005, a decrease of $1,020,232 or 79.3%. The main reason for the decrease is reduced accruals for RMA expenses. Now that the Company has been selling the LCD products for a full year, the Company has a track record at estimating returns and repairs. The Company believes its current accruals are sufficient to handle all expected returns and reserves.

Financing Activities. In October 2005, the Company borrowed $165,000 from an individual for working capital purposes. As of June 30, 2006, $100,000 is owed to that individual.

Principal Commitments:

A summary of the Company's contractual cash obligations as of June 30, 2006 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	$ 514,005	$ 212,692	$ 301,313	--	$ --
Note payable	100,000	100,000	--	--	--
Purchase Commitments	837,570	837,570	--	--	--
Total contractual cash obligations	$1,451,575	$1,150,262	$ 301,313	$ --	$ --

Purchase Commitments:

At June 30, 2006 the company had purchased inventory that had not yet arrived in the warehouse costing $837,570. The company had no other long term or short term purchase commitments.

Off-Balance Sheet Arrangements:

At June 30, 2006, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

Commitments and Contingencies:

At June 30, 2006, the Company did not have any material commitments for capital expenditures.

Recent Accounting Pronouncements:

In May 2005, FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS 154 applies to all voluntary accounting principle changes as well as the accounting for and reporting of such changes. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

SFAS 154 requires voluntary changes in accounting principle be retrospectively applied to financial statements from previous periods unless such application is impracticable. Changes in depreciation, amortization, or depletion for long-lived, non-financial assets are accounted for as a change in accounting estimate that is affected by a change in accounting principle, under the newly issued standard.

SFAS 154 replaces APB Opinion No. 20 and SFAS 3. SFAS 154 carries forward many provisions of Opinion 20 and SFAS 3 without change including those provisions related to reporting a change in accounting estimate, a change in reporting entity, correction of an error and reporting accounting changes in interim financial statements. The FASB decided to completely replace Opinion 20 and SFAS 3 rather than amending them in keeping to the goal of simplifying U.S. GAAP. The provisions of SFAS No. 154 are not expected to have a material effect on the Company's consolidated financial position or results of operation.

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 forNonmonetary Transactions, and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial

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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.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123(R)") which replaces SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123(R) requires that companies recognize all share-based payments to employees, including grants of employee stock options, in the financial statements. The cost will be based on the fair value of the equity or liability instruments issued and recognized over the respective vesting period of the stock option. Pro forma disclosure of this cost will no longer be an alternative under SFAS No. 123(R). SFAS 123(R) is effective for public companies at the beginning of the first fiscal year that begins after June 15, 2005.

Transition methods available to public companies include either the modified prospective or modified retrospective adoption. The modified prospective transition method requires that compensation cost be recognized beginning on the effective date, or date of adoption if earlier, for all share-based payments granted after the date of adoption and for all unvested awards existing on the date of adoption. The modified retrospective transition method, which includes the requirements of the modified prospective transition method, additionally requires the restatement of prior period financial information based on amounts previously recognized under SFAS No. 123 for purposes of pro-forma disclosures. The Company adopted SFAS No. 123(R) effective January 1, 2006.The Company adopted the modified prospective method. As a result, the Company recognized a charge against earnings of $256,524 for the six months ended June 30, 2006.

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.

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.

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, 2006 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

Evaluation of Disclosure and Control Procedures

Based on a current evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures as defined in rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act) were not effective as of June 30, 2006 and did not ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. 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 the fact that the Company's system of internal control requires considerable manual intervention to do the following: (1) to properly record accounts payable to vendors for purchases of inventory, (2) to properly record adjustments to inventory per the general ledger to physical inventory balances, (3) to properly record inventory adjustments to the lower of cost or market using the average inventory method, (4)to have adequate controls over interim physical inventory procedures, and 5) to 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 relevant contemporaneous documentation for ongoing business transactions, and 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 period ended June 30, 2006.

A significant deficiency should be classified as a material weakness if, by itself or in combination with other control deficiencies, it results in more than a remote likelihood that a material misstatement in the company's annual or interim financial statements will not be prevented or detected.

To address these significant deficiencies and material weaknesses, the Company took the following corrective actions:

- The Company hired a new Accounting Manager, then replaced the Accounting Manager with a more qualified candidate. That employee recently left the Company to return overseas for a family emergency. The employee will not be returning to the Company, which means that as of March 31, 2006, the Company is operating without an Accounting Manager or Controller. While the Company is searching for a replacement, the Company has retained a financial consultant and former CPA to oversee the day to day management of the accounting department. The Company has recently added additional personnel to complete the day to day accounting tasks. The Company hired a qualified accounting manager but resigned around August 2006. The Company needs and is seeking to immediately hire an Accounting Manager and additional personnel to focus on financial accounting and reporting issues.

- 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. These tasks will be supervised by the financial consultant until the new Accounting Manager is hired.

- Every month, the Accounting Manager 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. These tasks will be supervised by the financial consultant until the new Accounting Manager is hired.

- A complete inventory is physically counted and reconciled at the end of every month.

Changes in Internal Control over Financial Reporting

We made changes during our most recently completed fiscal quarter in our internal control over financial reporting that have materially affected , or are reasonably likely to materially affect, our internal control over financial reporting.

In light of the foregoing, in 2006, management took the following actions to rectify the significant deficiencies and material weaknesses as described above.

>> Management hired experts to assist with the financial reporting required, and to train Company employees to perform such tasks in the future.

>> Management hired experts to assist in the evaluation and implementation of new accounting software. The evaluation was completed, and the software has been paid for. The software will be installed and operational during the fourth quarter of 2006.

In conjunction with the audit review of the Company's financial statements for the quarter ended June 30, 2006, the Company's Chief Executive Officer and its Chief Financial Officer reviewed and evaluated the corrective actions listed above. The officers believed that such corrective actions minimize the risk of material misstatement, but the corrective actions continued to have significant deficiencies.

As of June 30, 2006, the Company is working quickly to hire an Accounting Manager and additional finance personnel. The Chief Executive Officer and the Chief Financial Officer are satisfied that with the personnel in place, and with the additional efforts of the Financial Consultant/ CPA, that the books and records portray a completely accurate picture of the Company's financial position and that all transactions are being captured and reported as required. The Company believes that once the new software is installed and operational, and the new Accounting Manager is hired, all significant deficiencies will have been addressed and corrected.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On August 2, 2004, a lawsuit was filed in California Superior Court entitled Gerry Normandan. et al, v. SOYO Inc. Case No. RCV 082128. The case seeks class action status and alleges defects in motherboards which Soyo distributes, and that the Company misrepresented and omitted material facts concerning the motherboards. The plaintiff seeks restitution and disgorgement of all amounts obtained by defendant as a result of alleged misconduct, plus interest, actual damages, punitive damages and attorneys' fees. The Company is vigorously defending the lawsuit and believes that it will be resolved with no material adverse effect on the Company.

On April 14, 2005 a lawsuit was filed in Superior Court of the State of California, County of San Bernardino, entitled Afshin Pourvajdi v. SOYO Group, Inc., Nancy Chu and various Doe defendants. Case RCV 086992. The complaint alleged causes of action for: 1) Double damages for violation of labor code Section 970; 2) Misrepresentation; 3) Intentional Infliction of Emotional

Distress; 4) Breach of Contract. The prayer for relief in the Complaint sought damages of no less than $200,000 on the first and second causes of action, plus an unspecified amount of punitive damages and an unspecified amount of general and punitive damages on the third cause of action and an unspecified amount of general and punitive damages on the fourth cause of action. Plaintiff also sought to recover all costs and attorney fees. The case arose from a consultant who worked for the Company in 2004 and whose contract was not renewed. The Company settled the case during the second quarter of 2006 for $70,000. Although the Company believes that it committed no wrongdoing, the cost of trying the case and retaining expert witnesses would have exceeded the cost of the settlement. The Company made a business decision to end the litigation with no possible further costs.

There are no other legal proceedings that have been filed against the Company.

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None of the Company's directors, officers or affiliates, or owner of record of more than five percent (5%) of its securities, or any associate of any such director, officer or security holder, is a party adverse to the Company or has a material interest adverse to the Company in reference to pending litigation.

ITEM 1A: RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

None

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

None

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 14, 2006

By: /s/ Ming Tung Chok

Ming Tung Chok
President and Chief
Executive Officer

DATE: August 14, 2006

By: /s/ Nancy Chu

Nancy Chu
Chief Financial Officer

DATE: August 14, 2006

By: /s/ Paul F. Risberg

Name: Paul F. Risberg
Title: Director

DATE: August 14, 2006

By: /s/ Chung Chin Keung

Name: Chung Chin Keung
Title: Director

DATE: August 14, 2006

By: /s/ Zhi Yang Wu

Name: Zhi Yang Wu
Title: Director

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
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - Ming Tung Chok
32.2	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 - Nancy Chu