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SUN NETWORK GROUP INC
Form 10QSB
May 25, 2004

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

FORM 10-QSB

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

For the fiscal quarter ended: March 31, 2004
Commission file number: 33-42498

SUN NETWORK GROUP, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Florida | 65-024624 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

1440 CORAL RIDGE DR., SUITE 140
CORAL SPRINGS, FLORIDA 33071
(Address of principal executive offices)
(Zip code)

(954) 360-4080
(Registrant's telephone number, including area code)

Indicate by check mark whether 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 the number of shares outstanding of each of the registrant's classes of common stock, as of May 3, 2004: 123,407,813 shares of common stock, \$.001 par value per share.

SUN NETWORK GROUP, INC. AND SUBSIDIARIES
FORM 10-QSB
QUARTERLY PERIOD ENDED MARCH 31, 2004
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SUN NETWORK GROUP, INC. AND SUBSIDIARIES
 CONSOLIDATED BALANCE SHEET
 MARCH 31, 2004
 (UNAUDITED)

ASSETS

| | |
|----------------------------------|------------|
| Current assets: | |
| Cash | \$ 228,502 |
| Deferred debt issuance cost, net | 63,000 |
| Prepays | 34,000 |
| | ----- |
| Total current assets | 325,502 |
| | ----- |
| Total assets | \$ 325,502 |
| | ----- |

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current liabilities:

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| | | |
|---|----|-------------|
| Convertible debentures, net | \$ | 390,619 |
| Accounts payable | | 9,453 |
| Accrued interest | | 825 |
| Accrued compensation, related party | | 215,992 |
| | | ----- |
| Total current liabilities | | 616,889 |
| Long-term debt | | 490,000 |
| | | ----- |
| Total liabilities | | 1,106,889 |
| | | ----- |
| Minority interest | | 38,127 |
| | | ----- |
| Stockholders' deficit: | | |
| Common stock (\$0.001 par value; 500,000,000 authorized shares; 154,407,813 shares issued; 98,407,813 outstanding) | | 98,407 |
| Common stock issuable (20,000,000 shares) | | 20,000 |
| Additional paid-in capital | | 3,934,175 |
| Accumulated deficit | | (4,469,929) |
| Deferred consulting | | (402,167) |
| | | ----- |
| Total stockholders' deficit | | (819,514) |
| | | ----- |
| Total liabilities and stockholders' deficit | \$ | 325,502 |
| | | ===== |

See accompanying notes to consolidated financial statements.

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SUN NETWORK GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | For the Three Months Ended March 31, | |
|---------------------------------|---|----------|
| | 2004 | 2003 |
| | ----- | ----- |
| REVENUES | \$ 2,415 | \$ 1,119 |
| | ----- | ----- |
| OPERATING EXPENSES: | | |
| Compensation | 37,500 | 40,986 |
| Amortization | -- | 3,699 |
| Bad debt | -- | 1,628 |
| Consulting | 1,112,233 | 7,805 |
| Debenture penalties | 30,000 | 100,726 |
| Debt issuance cost amortization | 7,000 | 5,000 |
| Impairment loss | -- | 20,910 |

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| | | |
|---|----------------|--------------|
| Professional fees | 10,143 | 31,443 |
| Other selling, general and administrative | 34,711 | 25,578 |
| | ----- | ----- |
| Total Operating Expenses | 1,231,587 | 237,775 |
| | ----- | ----- |
| LOSS FROM OPERATIONS | (1,229,172) | (236,656) |
| | ----- | ----- |
| OTHER INCOME (EXPENSES): | | |
| Settlement expense | (57,334) | (36,500) |
| Interest expense | (19,581) | (20,581) |
| Recovery of bad debt | 4,520 | 7,289 |
| Interest income | -- | 1,628 |
| | ----- | ----- |
| Total Other Expenses | (72,395) | (48,164) |
| | ----- | ----- |
| LOSS BEFORE MINORITY INTEREST | (1,301,567) | (284,820) |
| MINORITY INTEREST IN SUBSIDIARY LOSS | -- | 1,850 |
| | ----- | ----- |
| NET LOSS | \$ (1,301,567) | \$ (282,970) |
| | ===== | ===== |
| EARNING (LOSS) PER SHARE: | | |
| Net Loss Per Common Share - Basic and Diluted | \$ (0.02) | \$ (0.01) |
| | ===== | ===== |
| Weighted Common Shares Outstanding - Basic and Diluted | 79,961,349 | 28,048,487 |
| | ===== | ===== |

See accompanying note to consolidated financial statements.

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SUN NETWORK GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | For the Three Months Ended March 31, | |
|--|---|--------------|
| | 2004 | 2003 |
| | ----- | ----- |
| Cash flows from operating activities: | | |
| Net loss | \$ (1,301,567) | \$ (211,833) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Amortization expense | -- | 3,699 |
| Bad debt expense | -- | 1,628 |
| Impairment loss | -- | 20,910 |
| Amortization of deferred debt issuance costs | 7,000 | 5,000 |
| Amortization of debt discounts to interest | | |

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| | | |
|---|------------|-----------|
| expense | 875 | 6,387 |
| Stock based consulting expense | 1,112,233 | 36,500 |
| Settlement expense | 57,334 | -- |
| Allocation of loss to minority interest | -- | (1,850) |
| (Increase) decrease in: | | |
| Interest receivable | -- | (1,628) |
| Prepays | -- | (54,000) |
| Increase (decrease) in: | | |
| Accounts payable | 3,542 | 4,961 |
| Accrued interest | 18,706 | 14,194 |
| Accrued penalties | 30,000 | 29,589 |
| Accrued compensation, related party | 27,500 | 24,500 |
| | ----- | ----- |
| Net cash used in operating activities | (44,377) | (121,943) |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Proceeds from lonas payable | 490,000 | -- |
| Deferred debt issuance costs | (49,000) | -- |
| Payments on convertible debenture | (270,000) | -- |
| Proceed from loan from joint venture partner | -- | 50,000 |
| Proceeds from (payments on) loans from officer | -- | 2,000 |
| | ----- | ----- |
| Net cash provided by financing activities | 171,000 | 52,000 |
| | ----- | ----- |
| Net (decrease) increase in cash | 126,623 | (69,943) |
| Cash at beginning of year | 101,879 | 81,751 |
| | ----- | ----- |
| Cash at end of period | \$ 228,502 | \$ 11,808 |
| | ===== | ===== |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid during the period for: | | |
| Interest | \$ -- | \$ -- |
| | ===== | ===== |
| Income Taxes | \$ -- | \$ -- |
| | ===== | ===== |
| NON-CASH INVESTING AND FINANCING ACTIVITIES: | | |
| Common stock issued for debentures payable | \$ 62,188 | \$ -- |
| | ===== | ===== |
| Debt issuance costs deferred in connection with convertible debentures | \$ 49,000 | \$ -- |
| | ===== | ===== |

See accompanying notes to consolidated financial statements.

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NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Organization

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The accompanying consolidated financial statements for the interim periods are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position and consolidated operating results for the periods presented. These consolidated financial statements should be read in conjunction with the consolidated financial statements of Sun Network Group, Inc. for the years ended December 31, 2003 and 2002 and notes thereto contained in the Report on Form 10-KSB for the year ended December 31, 2003 as filed with the SEC. The results of operations for the three months ended March 31, 2004 are not necessarily indicative of the results for the full fiscal year ending December 31, 2004.

Sun Network Group, Inc. was incorporated under the laws of Florida on May 9, 1990 and was inactive for several years.

On September 5, 2002, the Company formed a general partnership with one other partner. The partnership, Radio X Network ("Radio X"), was formed to independently create, produce, distribute, and syndicate radio programs. The Company offers radio programs to radio stations in exchange for advertising time on those stations, which the Company then sells to advertisers. This is known in the media industry as "barter syndication." In return for providing the radio stations with programming content, the Company receives advertising minutes, which the Company then sells to advertisers. The amount of advertising minutes received is based on several factors, including the type and length of the programming and the audience size of the radio station affiliate. In some instances, the Company may also receive a monthly license fee in addition to or in lieu of the commercial inventory and may derive revenues from sponsorship and merchandising. Sun Network Group, Inc. acts as a holding company for Radio X and RadioTV Network, Inc. RadioTV Network Inc. is developing a business to produce and broadcast television versions of top rated radio programs.

Principles of Consolidation

The consolidated financial statements include the accounts of Sun Network Group, Inc., its wholly owned subsidiary, RadioTV Network, Inc., and its controlled subsidiary Radio X. All significant intercompany accounts and transactions have been eliminated in consolidation.

Revenue Recognition

The Company follows the guidance of the Securities and Exchange Commission's Staff Accounting Bulletin 104 for revenue recognition. In general, the Company records revenue when persuasive evidence of an arrangement exists, services have been rendered or product delivery has occurred, the sales price to the customer is fixed or determinable, and collectability is reasonably assured. The following policies reflect specific criteria for the various revenues streams of the Company:

The Company accounts for revenues from its Radio TV Network, Inc operations in accordance with the AICPA Accounting Standards Executive Committee Statement of Position No. 00-2, "Accounting by Producers or Distributors of Films" ("SOP 00-2").

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SUN NETWORK GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
March 31, 2004
(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Revenue Recognition (Continued)

The Company generally produces episodic television series and generates revenues from the sale of broadcast licenses and advertising sales. The terms of the licensing arrangement may vary significantly from contract to contract and may include fixed fees, variable fees with or without nonrefundable minimum guarantees, or barter arrangements.

The Company recognizes monetary revenues when evidence of a sale or licensing arrangement exists, the license period has begun, delivery of the film to the licensee has occurred or the film is available for immediate and unconditional delivery, the arrangement fee is fixed or determinable, and collection of the arrangement fee is reasonably assured. The Company recognizes only the net revenue due to the Company pursuant to the formulas or amounts stipulated in the customer contracts.

The Company recognizes revenues from barter arrangements in accordance with the Accounting Principles Board Opinion No. 29 "Accounting for Non-Monetary Exchanges," ("APB 29") as interpreted by EITF No. 93-11 "Accounting for Barter Transactions Involving Barter Credits." In general, APB 29 and its related interpretation require barter revenue to be recorded at the fair market value of what is received or what is surrendered, whichever is more clearly evident.

The Company recognizes revenues from the sale of radio program advertising in its Radio X Network operations when the fee is determinable and after the commercial advertisements are broadcast. Any amounts received from customers for radio advertisements that have not been broadcast during the period are recorded as deferred revenues until such time as the advertisement is broadcast.

The Company recognizes radio program license fee revenues when evidence of a licensing arrangement exists, the license period has begun, delivery of the program to the licensee has occurred or is available for immediate and unconditional delivery, the arrangement fee is fixed or determinable, and collection of the arrangement fee is reasonably assured.

NOTE 2 - CONVERTIBLE DEBENTURES AND WARRANTS AND DEFAULT

On June 27, 2002, the Company entered into a Securities Purchase Agreement to issue and sell 12% convertible debentures, in the aggregate amount of \$750,000, convertible into shares of common stock, of the Company. As of June 27, 2002, \$250,000 in convertible debentures were issued to various parties. The holders of this debt have the right to convert all or any amount of this debenture into fully paid and non-assessable shares of common stock at the conversion price with the limitation that any debenture holder may not convert any amount of the debentures if after conversion that debenture holder would beneficially hold more than 4.9% of the total outstanding common stock of the Company. However, any debenture holder may waive this limitation provision with 61 days written notice to the Company. The conversion price generally is the lesser of (a) 50% of the market value of the common stock as defined in the debenture or (b) \$0.15. Interest is payable either quarterly or at the conversion date at the option of the holder. These convertible debentures matured on June 27, 2003, and

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are secured by substantially all present and future assets of the Company. On August 8, 2002, an additional \$250,000 of convertible debentures were purchased from the Company and matured on August 8, 2003 (see default discussion below). On November 7, 2003, an additional \$250,000 of convertible debentures were purchased from the Company with the terms similar to that described above and mature on November 8, 2004

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SUN NETWORK GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
March 31, 2004
(UNAUDITED)

NOTE 2 - CONVERTIBLE DEBENTURES AND WARRANTS (CONTINUED)

Since a registration statement relating to the debentures was not declared effective within 90 days of June 27, 2002, the Company is obligated to pay a fee to the debenture holders equal to 2% per month on the principal balance outstanding. The registration statement was declared effective on October 30, 2003. In connection with this penalty, the Company had previously recorded \$130,849 in penalty fee expenses resulting in a total accrued penalty related to this penalty of \$130,849 through the date of redemption (March 8, 2004).

Under the debenture, the Company incurred a liquidated damages penalty for not having enough authorized shares to allow for the issuance of all dilutive securities based on a formula as stipulated in the Debenture agreement or for not reporting to the debenture holder's on a timely basis as stipulated in the Debenture Agreement. The penalty rate is computed as 3% of the outstanding debenture balance per month, which computes to \$15,000 per month. The accrued penalty through March 8, 2004 (date of redemption agreement) amounted to \$236,137. Although the Company authorized the increase of its authorized shares to 200,000,000 in May 2003 and then to 500,000,000 in October 2003, this increase was not sufficient to satisfy the required authorized shares pursuant to the Debenture Agreement and therefore the penalty has been accrued through the redemption date (March 7, 2004).

On June 28, 2003 and on August 8, 2003 (the "Default Dates"), the Company defaulted on its maturity date payments on \$500,000 of debentures. A default penalty expense was computed under the terms of the debenture as \$179,492 and has been charged to operations in fiscal 2003 from the Default Dates through December 31, 2003 and included in accrued penalty.

In addition, interest accrued at the default rate of 15% from the default dates.

During December 2003 to the date of redemption (March 8, 2004), \$87,194 of debentures were converted into 15,159,326 shares of common stock (see note 4). Additionally, through March 31, 2004, the Company repaid debenture holders \$270,000.

On March 8, 2004, the Company entered into a redemption agreement with its debenture holders, whereby the Company agreed to pay \$150,000 per week for five weeks commencing on March 22, 2004 until such time as the Company has paid \$750,000. Upon final payment, the Company delivered 20,000,000 shares of common stock to the debenture holders as full satisfaction of all accrued liabilities under the debenture agreements. In May 2004, the Company paid funds due to the debenture holders in full satisfaction of all liabilities. In connection with the redemption agreement, the Company reduced accrued penalties as discussed above amounting to \$546,478 and reduced accrued interest of \$116,188, as of March 31, 2004. The Company valued the 20,000,000 shares of common stock due upon full satisfaction of the debt on the date of the redemption agreement of

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\$720,000 or \$.036 per share. Accordingly, the Company recorded settlement expense of \$57,334.

The convertible debenture liability is as follows at March 31, 2004:

| | | |
|---|----|---------|
| Convertible debenture | \$ | 392,806 |
| Less: unamortized discount on debenture | | (2,187) |
| Convertible debenture, net | \$ | 390,619 |
| | | ===== |

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SUN NETWORK GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
March 31, 2004
(UNAUDITED)

NOTE 3 - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board has recently issued several new accounting pronouncements:

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. Statement 148 provides alternative methods of transition to Statement 123's fair value method of accounting for stock-based employee compensation. It also amends the disclosure provisions of Statement 123 and APB Opinion No. 28, Interim Financial Reporting, to require disclosure in the summary of significant accounting policies of the effects of an entity's accounting with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. Statement 148's amendment of the transition and annual disclosure requirements of Statement's 123 are effective for fiscal years ending after December 15, 2002. Statement 148's amendment of the disclosure requirements of Opinion 28 is effective for interim periods beginning after December 15, 2002. The adoption of the disclosure provisions of Statement 148 as of December 31, 2002 did not have a material impact on the Company's financial condition or results of operations.

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities." FIN 46 requires that if an entity has a controlling financial interest in a variable interest entity, the assets, liabilities and results of activities of the variable interest entity should be included in the consolidated financial statements of the entity. FIN 46 requires that its provisions are effective immediately for all arrangements entered into after January 31, 2003. The Company does not have any variable interest entities created after January 31, 2003. For those arrangements entered into prior to January 31, 2003, the FIN 46 provisions are required to be adopted at the beginning of the first interim or annual period beginning after June 15, 2003. The Company has not identified any variable interest entities to date and will continue to evaluate whether it has variable interest entities that will have a significant impact on its consolidated balance sheet and results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for the first interim period beginning after June 15, 2003, with certain exceptions. The adoption of SFAS No. 150 did not have a significant impact on our consolidated financial position or results

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of operations.

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SUN NETWORK GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
March 31, 2004
(UNAUDITED)

NOTE 4 - STOCKHOLDERS' DEFICIT

Common Stock

During the three months ended March 31, 2004, in connection with the conversion of debentures payable, the Company issued 6,260,998 shares of common stock upon the conversion of debentures payable amounting to \$62,188.

During the three months ended March 31, 2004, the Company entered into agreements with third parties for management consulting, business advisory, shareholder information and public relations services. In connection with these agreements, the Company issued such consultants 36,800,000 shares of its common stock for these services. The Company valued these shares at the quoted trading price on the date of the agreement at prices ranging from \$0.026 to \$0.043 per common share, and recorded consulting expense of \$990,233 and deferred consulting expense of \$388,167 to be amortized over the contract terms.

In connection with the redemption agreement, the Company issued 20,000,000 shares of common stock to the debenture holders as full satisfaction of liabilities under the debenture agreements. These shares were valued on the date of the redemption agreement at fair market value based on the quoted trading price of the stock (see Note 2).

NOTE 5 - LOAN PAYABLE

In March, 2004, the Company entered into two loan agreements to borrow \$273,000 and \$217,000, respectively. The loans bear interest at a rate equal to the prevailing 30-day LIBOR rate plus 100 basis points. Interest on the loans is computed on the basis of 360-day year for the number of actual days elapsed and is due and payable quarterly commencing June 2, 2004. The loans are due in March 2006. If the loans are not paid by the close of business on the due date in March 2006, the Company shall pay the lender a late charge equal to five percent of the outstanding principal balance. The Company paid a cash fee equal 10% of the amount borrowed which is deducted directly from the proceeds by the lender. These fees are recorded as deferred debt issuance costs and amortized over the loan term. The loans are collateralized by 28,000,000 shares of the Company's common stock. In addition, the Company issued an additional 28,000,000 common shares into escrow as collateral during March 2004 in anticipation of future borrowings. The collateral shares are not considered outstanding for accounting purposes and do not have voting rights until and unless they are foreclosed upon due to any future default as stipulated in the agreements.

NOTE 6 - IMPAIRMENT LOSS

The Company received certain capital stock of a private German company in exchange for a prepaid expense of \$20,910 that was recorded at December 31, 2002. As the valuation of the capital stock received could not be supported based on valuation or other objective data, the Company elected to conservatively impair this asset for accounting purposes. Accordingly, the Company recorded an impairment loss of \$20,910 for the three months ended March

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31, 2003.

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SUN NETWORK GROUP, INC. AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
 March 31, 2004
 (UNAUDITED)

NOTE 7 - REPORTABLE SEGMENTS

As of March 31, 2004 and 2003, the Company had two reportable segments: Network TV and Network Radio. The Company's reportable segments have been determined in accordance with the Company's internal management structure. The following table sets forth the Company's financial results by operating segments:

| March 31, 2004 | Network TV | Network Radio | Total |
|--------------------------|----------------|---------------|----------------|
| ----- | ----- | ----- | ----- |
| Assets | \$ 325,502 | \$ - | \$ 325,502 |
| Revenues | \$ - | 2,415 | \$ 2,415 |
| Amortization | - | - | - |
| Other operating expenses | (1,224,652) | (6,935) | (1,231,587) |
| Interest expense | (19,581) | - | (19,581) |
| Settlement expense | (57,334) | - | (57,334) |
| Recovery of bad debt | - | 4,520 | 4,520 |
| | ----- | ----- | ----- |
| Segment loss | \$ (1,301,567) | \$ - | \$ (1,301,567) |
| | ===== | ===== | ===== |
| | | | |
| March 31, 2003 | Network TV | Network Radio | Total |
| ----- | ----- | ----- | ----- |
| Assets | \$ 70,808 | \$ 6,493 | \$ 77,301 |
| Revenues | \$ - | 1,119 | \$ 1,119 |
| Amortization | - | (3,699) | (3,699) |
| Other operating expenses | (262,168) | (8,408) | (270,576) |
| Interest income | 1,628 | - | 1,628 |
| Interest expense | (20,581) | - | (20,581) |
| Recovery of bad debt | - | 7,289 | 7,289 |
| Minority interest | - | 1,850 | 1,850 |
| | ----- | ----- | ----- |
| Segment loss | \$ (281,121) | \$ (1,849) | \$ (282,970) |
| | ===== | ===== | ===== |

NOTE 8 - GOING CONCERN

As reflected in the accompanying consolidated financial statements, the Company had an accumulated deficit of \$4,469,929 and a working capital deficit of \$291,387 at March 31, 2004, and cash used in operations in for the three months ended March 31, 2004 of \$44,377. In addition, revenues were nominal. Through November 2003, the Company received approximately \$582,000 in funding, net of \$168,000 of fees. Additionally, through March 31, 2004, the Company borrowed \$490,000 under loan agreements to pay back the debenture holders.

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Management expects operations to generate negative cash flow at least through December 2004 and the Company does not have existing capital resources or credit lines available that are sufficient to fund operations and capital requirements as presently planned over the next twelve months. The Company's ability to raise capital to fund operations is further constrained because they have already pledged substantially all of their assets and have restrictions on the issuance of the common stock. The Company expects to generate substantially all revenues in the future from sales of Radio X Network programs. However, the Company's limited financial resources have prevented the Company from aggressively advertising its product to achieve consumer recognition. The ability of the Company to continue as a going concern is dependent on the Company's ability to further implement its business plan and generate revenues. The consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern. Management believes that the actions presently being taken to further implement its business plan and generate additional revenues provide the opportunity for the Company to continue as a going concern.

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SUN NETWORK GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
March 31, 2004
(UNAUDITED)

NOTE 9 - SUBSEQUENT EVENT

In April 2004, the Company borrowed additional fund of \$334,000 under loan agreements and paid \$33,400 in debt issuance costs.

In April 2004, the Company entered into an agreement with a third party for management consulting, business advisory, shareholder information and public relations services. In connection with this agreement, the Company issued such consultant 5,000,000 shares of its common stock for these services. The Company valued these shares at the quoted trading price on the date of the agreement at \$.036 per common share, and recorded consulting expense of \$180,000.

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

OVERVIEW

The Company acquired all of the assets of RadioTV Network, Inc ("RTV") on July 16, 2001 in a transaction treated as a recapitalization of RTV. RTV has been developing and operating, for the past few years, a new television network that produced and distributed TV adaptations of top rated radio programs and also produces and distributes radio programs through a partnership with an established radio network.

On June 27, 2002 the Company entered into agreement with four (4) institutional investors to provide the Company \$750,000 in capital through a Secured Convertible Debenture Offering ("Debenture")..

On June 28, 2002 the Company entered into an Option Agreement and Plan of Merger ("Agreement") to acquire all of the assets of Live Media Enterprises, Inc ("Live"), a west coast based independent producer of consumer lifestyle events. On September 3, 2002 the Company elected to terminate the Agreement with Live and will not proceed with the acquisition even on modified terms. In connection with the Agreements the Company has loaned Live the sum of \$56,000. This loan is documented in two Promissory Notes and is collateralized by substantially all of the assets of Live and personally guaranteed by Live's principal shareholder and

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officer. The Company is presently attempting to collect its debts from Live in the Los Angeles Superior Court.

On September 5, 2002, the Company entered into agreement with Sports Byline USA, L.P. to own and operate a new, national radio network, Radio X. Radio X intends to develop, produce, license, broadcast and distribute radio programs, targeted to young males that will be distributed via traditional terrestrial stations, via satellite and over the Internet. The Company has contributed the sum of \$100,000 to this business plus certain management services. Our partnership interest is 50%, however, we have an overriding voting control over all matters of the partnership. Radio X currently has three radio programs in distribution.

The Company intended to use the net proceeds from the Debenture to develop, operate and expand the businesses of RTV and Radio X and continues to seek other opportunities for the Company. In 2004, the Company entered into loan agreements and borrowed a total of \$824,000 and received proceeds of \$741,600, net of debt issue costs and paid back the debenture holders \$750,000. The Company believes that through its loan borrowings, it will have sufficient capital to operate through the end of 2004. The Company will, however, continue to seek additional capital to fund further development, expansion and operation of its businesses. Upon conversion of the Debentures into the Company common stock there will be substantial shareholder dilution.

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

RESULTS OF OPERATIONS

Three months ended March 31, 2004 compared to the three months ended March 31, 2003

REVENUES

Revenues for the three months ended March 31, 2004 were \$2,415 as compared to revenues for the three months ended March 31, 2003 of \$1,119 and were derived from our consolidated subsidiary, Radio X Network.

OPERATING EXPENSES

Compensation was \$37,500 for the three months ended March 31, 2004 compared to \$40,986 for the comparable period in 2003. Compensation relates solely to compensation under our employment agreement with our president.

Amortization of radio programs of \$0 and \$3,699 for the three months ended March 31, 2004 and 2003, respectively, results from amortizing the radio programs intangible assets that resulted from the investment by our subsidiary, RadioTV Network, Inc, in the Radio X Network.

Consulting expense for the three months ended March 31, 2004 was \$1,112,233 compared to \$7,805 for the three months ended March 31, 2003. During the three months ended March 31, 2004, consulting expense related to the issuance of common stock for services.

The Debenture penalty of \$30,000 and \$100,726 for the three months ended March 31, 2004 and 2003, respectively, represents the accrued penalty under the provisions of the Convertible Debentures. The penalties relate to the deadlines associated with the Company filing a Registration Statement in connection with the Convertible Debentures and liquidated damages penalty for not having enough authorized shares to allow for the issuance of all dilutive securities based on

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a formula as stipulated in the Debenture agreement and a default penalty on the June 28, 2003 and August 8, 2003 maturity of \$500,000 of debentures

For the three months ended March 31, 2003, the Company had an impairment loss of \$20,910 as compared to \$0 for the three months ended March 31, 2004. The impairment relates to certain capital stock received in a German private company in lieu of a refund of a prepaid expense paid to a service provider. Since there was no objective valuation data supporting the value of the capital stock received, the Company elected to impair this asset.

Professional fees for the three months ended March 31, 2004 were \$10,143 compared to \$31,443 for the three months ended March 31, 2003. The decrease is primarily related to accounting and legal, audit and registration statement related services regarding our filing a SB-2 in the 2003 period.

Other selling, general and administrative expenses were \$34,711 for the three months ended March 31, 2004 as compared to \$25,578 for the three months ended March 31, 2003. The increase in expenses is primarily due to an increase in travel related expense for the three months ended March 31, 2004 as compared to the three months ended March 31, 2003.

Interest expense was \$19,581 for the three months ended March 31, 2004 compared to \$20,581 for the three months ended March 31, 2003. Interest expense is attributed to the Convertible Debenture offering and includes accrued interest of the Convertible Debentures and amortization of the debt discount as well as accrued interest on the Convertible Debentures due to the default on payment.

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For the three months ended March 31, 2004, we recognized settlement expense of \$57,334 related to the redemption of the debentures. On February 4, 2003, the Company settled a lawsuit by issuing 1,000,000 common shares and \$6,500 in cash. The shares were valued at the quoted trading price of \$0.03 per share on the settlement date resulting in a total settlement expense of \$36,500.

As a result of these factors, we reported a net loss of \$1,301,567 or \$(.02) per share for the three months ended March 31, 2004 as compared to a net loss of \$282,970 or \$(.01) per share for the three months ended March 31, 2003.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2004, we had a stockholders' deficit of \$819,514. Our operations have been funded by an equity investor in our common stock where we issued 183,088 common shares for \$82,390 cash during 2002, by the sale of convertible debentures of \$750,000 through November 2003, and net proceeds from loan of \$741,600 through May 2004. These funds were used primarily for working capital, capital expenditures, advances to third parties in anticipation of entering into a merger or acquisition agreement and to pay down certain related party loans. The cash balance at March 31, 2004 was \$228,502 and was used to pay back debenture holders and we will have to minimize operations until we receive additional cash flows from our businesses or complete additional financing.

We have no other material commitments for capital expenditures except for the anticipated launch of a RadioTV Network program in late 2004. Other than several thousand dollars to be generated from our advertising sales from the broadcast of our initial program on the Radio X Network, debenture proceeds, loan proceeds, and warrant exercise proceeds we have no external sources of liquidity. Although we believe we will have sufficient capital to fund our anticipated operations through fiscal 2004, we are not currently generating meaningful revenues and, unless we raise additional capital, we may not be able to continue operating beyond fiscal 2004.

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Net cash used in operations during the three months ended March 31, 2004 was \$44,377 and was substantially attributable to net loss of \$1,301,567 offset primarily by non-cash stock based expenses of \$1,112,233, settlement expense of \$57,334, non-cash debt discount amortization of \$875, amortization of deferred debt issuance costs of \$7,000, and net changes in operating assets and liabilities of \$79,748. In the comparable period of 2003, we had net cash used in operations of \$121,943 primarily relating to the net loss of \$211,833 primarily offset by an impairment loss of \$20,910 and stock-based consulting expense of \$36,500.

Net cash provided by financing activities for the three months ended March 31, 2004 was \$171,000 as compared to net cash provided by financing activities of \$52,000 for the three months ended March 31, 2003. During the three months ended March 31, 2004, we received proceeds from loans of \$490,000, paid debt issuance costs of \$49,000 and repaid debenture holders \$270,000. In the comparable period of 2003, we received a loan from a joint venture partner of \$50,000 and proceeds from an officer loan of \$2,000.

For the fiscal year ended December 31, 2003, our auditors have issued a going concern opinion in connection with their audit of the Company's financial statements. These conditions raise substantial doubt about our ability to continue as a going concern if sufficient additional funding is not acquired or alternative sources of capital developed to meet our working capital needs.

CRITICAL ACCOUNTING POLICIES

A summary of significant accounting policies is included in Note 1 to the audited financial statements included in our Annual Report on Form 10-K, as amended, for the year ended December 31, 2002 as filed with the United States Securities and Exchange Commission. We believe that the application of these policies on a consistent basis enables us to provide useful and reliable financial information about our operating results and financial condition.

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ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

REVENUE RECOGNITION

We follow the guidance of the Securities and Exchange Commission's Staff Accounting Bulletin 104 for revenue recognition. In general, the Company records revenue when persuasive evidence of an arrangement exists, services have been rendered or product delivery has occurred, the sales price to the customer is fixed or determinable, and collectability is reasonably assured. The following policies reflect specific criteria for the various revenues streams of the Company:

We account for revenues from its Radio TV Network, Inc operations in accordance with the AICPA Accounting Standards Executive Committee Statement of Position No. 00-2, "Accounting by Producers or Distributors of Films" ("SOP 00-2").

We generally produce episodic television series and generates revenues from the sale of broadcast licenses and advertising sales. The terms of the licensing

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arrangement may vary significantly from contract to contract and may include fixed fees, variable fees with or without nonrefundable minimum guarantees, or barter arrangements.

We recognize monetary revenues when evidence of a sale or licensing arrangement exists, the license period has begun, delivery of the film to the licensee has occurred or the film is available for immediate and unconditional delivery, the arrangement fee is fixed or determinable, and collection of the arrangement fee is reasonably assured. We recognize only the net revenue due to the Company pursuant to the formulas or amounts stipulated in the customer contracts.

We recognize revenues from barter arrangements in accordance with the Accounting Principles Board Opinion No. 29 "Accounting for Non-Monetary Exchanges," ("APB 29") as interpreted by EITF No. 93-11 "Accounting for Barter Transactions Involving Barter Credits." In general, APB 29 and its related interpretation require barter revenue to be recorded at the fair market value of what is received or what is surrendered, whichever is more clearly evident.

We recognize revenues from the sale of radio program advertising in its Radio X Network operations when the fee is determinable and after the commercial advertisements are broadcast. Any amounts received from customers for radio advertisements that have not been broadcast during the period are recorded as deferred revenues until such time as the advertisement is broadcast.

We recognize radio program license fee revenues when evidence of a licensing arrangement exists, the license period has begun, delivery of the program to the licensee has occurred or is available for immediate and unconditional delivery, the arrangement fee is fixed or determinable, and collection of the arrangement fee is reasonably assured.

STOCK BASED COMPENSATION

We account for stock transactions with employees in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." In accordance with Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation," we adopted the pro forma disclosure requirements of SFAS 123. We account for stock issued to non-employees in accordance with SFAS 123 and related interpretations.

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ITEM 3. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our chief executive officer and chief financial officer, conducted an evaluation of our "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 (the "Exchange Act") Rules 13a-14I) within 90 days of the filing date of this Quarterly Report on Form 10-QSB (the "Evaluation Date"). Based on their evaluation, our chief executive officer and chief financial officer have concluded that as of the Evaluation Date, our disclosure controls and procedures are effective to ensure that all material information required to be filed in this Quarterly Report on Form 10-QSB has been made known to them in a timely fashion.

Changes in Internal Controls

There have been no significant changes (including corrective actions with regard to significant deficiencies or material weaknesses) in our internal controls or in other factors that could significantly affect these controls subsequent to

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the Evaluation Date set forth above.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Use of Proceeds

In October 2003, we changed the number of authorized common shares to 500,000,000.

Item 4. Submission of Matters to Vote of Security Holders

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

| | |
|------|--|
| 31.1 | Certification by Chief Executive Officer Pursuant to Section 302 |
| 31.2 | Certification by Chief Financial Officer Pursuant to Section 302 |
| 32.1 | Certification by Chief Executive Officer Pursuant to Section 906 |
| 32.2 | Certification by Chief Financial Officer Pursuant to Section 906 |

Reports on Form 8-K

None

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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.

SUN NETWORK GROUP, INC.

Dated: May 24, 2004

By: /s/ T. Joseph Coleman

T. Joseph Coleman
Chief Executive Officer,
President and Director

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