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SUN NETWORK GROUP INC
Form 10QSB
November 22, 2004

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

FORM 10-QSB

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2004

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____

33-42498
(Commission file number)

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

FLORIDA
(State or other jurisdiction
of incorporation or organization)

65-024624
(IRS Employer
Identification No.)

1440 CORAL RIDGE DRIVE, SUITE 140 CORAL SPRINGS, FLORIDA 33071
(Address of principal executive offices)

(954) 360-4080
(Issuer's telephone number)

N/A
(Former name, former address and former fiscal year,
if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

The number of shares of common stock as of November 15, 2004 was 323,157,813, including 56,000,000 collateral shares.

Transitional Small Business Disclosure Format (check one): Yes No

SUN NETWORK GROUP, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

SUN NETWORK GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

SEPTEMBER 3

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| | 2004 |
|--|----------------------|
| | ----- (unaudited) |
| ASSETS | |
| CURRENT ASSETS | |
| Cash and cash equivalents | \$ 553 |
| Stock subscription receivable | 70,000 |
| | ----- |
| TOTAL CURRENT ASSETS | 70,553 |
| DEFERRED DEBT ISSUANCE COSTS, net | 52,550 |
| | ----- |
| TOTAL ASSETS | \$ 123,103 |
| | ===== |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | |
| CURRENT LIABILITIES | |
| Loans payable | \$ 824,000 |
| Accounts payable | 2,600 |
| Accrued interest | 20,665 |
| Due to stockholder | 7,000 |
| | ----- |
| TOTAL CURRENT LIABILITIES | 854,265 |
| | ----- |
| MINORITY INTEREST | 38,127 |
| STOCKHOLDERS' DEFICIT | |
| Common stock; \$0.001 par value; 500,000,000 shares authorized; 323,157,813 shares issued and 267,157,813 shares outstanding | 267,158 |
| Additional paid-in capital | 6,364,375 |
| Accumulated deficit | (6,717,134) |
| Deferred consulting | (621,188) |
| Stock subscription receivable | (62,500) |
| | ----- |
| TOTAL STOCKHOLDERS' DEFICIT | (769,289) |
| | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT | \$ 123,103 |
| | ===== |

The accompanying notes are an integral part of these consolidated financial statements.

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

| THREE MONTHS ENDED | | |
|--------------------------------|-----------------------|--------------------------------|
| ----- SEPTEMBER 30, 2004 | SEPTEMBER 30, 2003 | ----- SEPTEMBER 30, 2002 |

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| | ----- (unaudited) | ----- (unaudited) | ----- (unaudited) |
|---|----------------------|----------------------|----------------------|
| REVENUES | \$ 1,875 | \$ 6,769 | \$ |
| OPERATING EXPENSES | | | |
| Compensation - officer | 1,410,500 | 37,500 | 1,5 |
| Amortization | -- | 2,794 | |
| Bad debt | -- | 1,663 | |
| Consulting | 235,619 | 2,629 | 1,6 |
| Debenture penalties | -- | 167,408 | |
| Debt issue cost amortization | 8,925 | -- | |
| Impairment loss | -- | -- | |
| Professional fees | (139) | 7,344 | |
| Other selling, general and administrative | 17,566 | 20,775 | 1 |
| TOTAL OPERATING EXPENSES | 1,672,471 | 240,113 | 3,3 |
| LOSS FROM OPERATIONS | (1,670,596) | (233,344) | (3,3 |
| OTHER INCOME (EXPENSE) | | | |
| Settlement expense | -- | -- | (1 |
| Interest expense | (19,775) | (30,327) | (|
| Recovery of bad debt | 4,724 | 2,946 | |
| Interest income | -- | 1,663 | |
| TOTAL OTHER INCOME (EXPENSE) | (15,051) | (25,718) | (1 |
| LOSS BEFORE MINORITY INTEREST | (1,685,647) | (259,062) | (3,5 |
| MINORITY INTEREST IN SUBSIDIARY LOSS | -- | 1,397 | |
| NET LOSS | \$ (1,685,647) | \$ (257,665) | \$ (3,5 |
| NET LOSS PER SHARE - BASIC AND DILUTED | \$ (0.01) | \$ (0.01) | \$ |
| WEIGHTED AVERAGE COMMON EQUIVALENT SHARES OUSTANDING - BASIC AND DILUTED | 183,838,791 | 28,448,487 | 131,0 |

The accompanying notes are an integral part of these consolidated financial statements.

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

NINE MONTHS ENDE

SEPTEMBER 30, SEPTE

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| | 2004 | 2003 |
|--|------------------|---------------------|
| | ----- | ----- |
| | (unaudited) | (unaudited) |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$ (3,548,772) | \$ (7,000,000) |
| Adjustment to reconcile net loss to net cash used in operating activities: | | |
| Amortization expense | -- | |
| Bad debt expense | -- | |
| Impairment loss | -- | |
| Amortization of deferred debt issue costs | 39,850 | |
| Amortization of debt discounts to interest expense | 3,062 | |
| Stock based consulting and compensation expense | 3,096,871 | |
| Settlement expense | 144,527 | |
| Allocation of loss to minority interest | -- | |
| Changes in: | | |
| Interest receivable | -- | |
| Prepays | 34,000 | |
| Accounts payable | (3,311) | |
| Accrued interest | 38,547 | |
| Accrued expenses | -- | |
| Accrued penalties | 30,000 | |
| Accrued compensation, related party | 54,300 | |
| | ----- | ----- |
| Net cash used in operating activities | (110,926) | (1,000,000) |
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from loans payable | 824,000 | |
| Payment of debt issue costs | (71,400) | |
| Payment on convertible debenture | (750,000) | |
| Proceeds from stockholder advance | 7,000 | |
| Proceeds fro loan from joint venture partner | -- | |
| Proceeds from loans from officer | -- | |
| | ----- | ----- |
| Net cash provided by financing activities | 9,600 | |
| | ----- | ----- |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (101,326) | (1,000,000) |
| CASH AND CASH EQUIVALENTS, Beginning of period | 101,879 | 1,000,000 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS, End of period | \$ 553 | \$ 1,000,000 |
| | ===== | ===== |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Interest paid | \$ -- | \$ -- |
| | ===== | ===== |
| Income taxes paid | \$ -- | \$ -- |
| | ===== | ===== |
| SUPPLEMENTAL NON-CASH INVESTING AND FINANCING ACTIVITIES: | | |
| Common stock issued for debentures payable | \$ 62,188 | \$ -- |
| | ===== | ===== |
| Debt issue costs deferred in connection with convertible debentures | \$ 49,000 | \$ -- |
| | ===== | ===== |
| Common stock issue for accrued compensation | \$ 242,792 | \$ -- |
| | ===== | ===== |

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The accompanying notes are an integral part of these consolidated financial statements.

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

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 Company's Annual Report on Form 10-KSB for the year ended December 31, 2003 as filed with the SEC. The results of operations for the nine months ended September 30, 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

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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:

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

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").

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

Prior to fiscal 2004, the Company had received \$750,000 pursuant to a Securities Purchase Agreement to issue and sell 12% convertible debentures. The holders of this debt had 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 of the lesser of (a) 50% of the market value of the common stock as defined in the debenture or (b) \$0.15. Interest was payable either quarterly or at the conversion date at the option of the holder.

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Since a registration statement relating to the debentures was not declared effective within 90 days of June 27, 2002, the Company was 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 in 2003 \$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).

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

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 was computed as 3% of the outstanding debenture balance per month, which computed to \$15,000 per month. The penalty expense from January 1, 2004 to March 8, 2004 (date of redemption) was \$20,000. 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 had 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 was 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, from March 2004 to May 2004, the Company repaid debenture holders \$750,000.

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 paid the debenture holders cash of \$750,000, 20,000,000 shares of common stock valued at \$720,000 or \$.036 per share, and \$87,194 of common shares upon conversion of the debentures. These were in full satisfaction of accrued penalties and liquidating damages of \$546,478, accrued interest of \$116,188, and debenture liabilities of \$750,000 resulting in an aggregate settlement expense of \$144,527.

NOTE 3 - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board has recently issued several new

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accounting pronouncements:

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 of operations.

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

NOTE 4 - STOCKHOLDERS' DEFICIT

COMMON STOCK

During the nine months ended September 30, 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.

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).

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 \$1,211,733 and deferred consulting expense of \$166,667 to be amortized over the one-year contract term.

During the three months ended June 30, 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 13,500,000 shares of its common stock for

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these services. The Company valued these shares at the quoted trading price on the date of the agreement at prices ranging from \$0.027 to \$0.036 per common share (total of \$420,000), and recorded consulting expense of \$50,358 and deferred consulting expense of \$369,642 to be amortized over the contract terms.

In May 2004, the Company issued 10,000,000 shares of common stock to an officer of the Company for all accrued compensation through June 30, 2004. The Company valued these shares at the quoted trading price on the date of grant of \$0.03 per common share, and reduced accrued compensation by \$242,792 and recorded non-cash compensation expense of \$57,208.

During the three months ended September 30, 2004, the Company issued shares to third parties and the Company's CEO for past management consulting, business advisory, shareholder information and public relations services. In connection with these agreements, the Company issued such consultants and employee 72,250,000 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 \$0.007 to \$0.025 per common share, and recorded consulting expense of \$1,434,950 with \$1,410,500 charged to compensation - officer and \$24,450 charged to consulting.

In September 2004, the Company entered into a private stock placement and consulting agreement whereby the Company agreed to sell 53,000,000 shares of its common stock for \$0.0025 per share or \$132,500. The services have been valued at the difference between the quoted trading price on the date prior to the agreement date and the price paid per shares or \$0.0055 per share. The \$291,500 allocated to services will be amortized over the two year term of the contract with \$13,765 recognized as consulting expense as of September 30, 2004.

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

Subsequent to September 30, 2004, the Company has received \$70,000 of the proceeds which is shown as a current asset in the accompanying consolidated balance sheet. The remaining \$62,500 is shown as a reduction in stockholder's deficit in the accompanying consolidated balance sheet.

NOTE 5 - LOANS PAYABLE

From March to April, 2004, the Company entered into 2-year loan agreements and borrowed an aggregate of \$824,000. 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 to 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 56,000,000 shares of the Company's common stock. 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. Accrued interest was \$20,665 at September 30, 2004. The Company defaulted on the \$824,000 loans payable in June 2004 due to non-payment of required interest payments. Accordingly, the lender may take possession of collateral and may

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exercise its rights to voting the 56,000,000 collateral common shares. Additionally, due to the default, the loans become due on demand and accordingly are reflected as current liabilities.

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 nine months ended September 30, 2003.

NOTE 7 - REPORTABLE SEGMENTS

As of September 30, 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:

September 30, 2004

| | NETWORK TV ----- | NETWORK RADIO ----- | TOTAL ----- |
|--------------------------|------------------------|------------------------|------------------------|
| Assets | \$ 123,103 ===== | \$ -- ===== | \$ 123,103 ===== |
| Revenue | \$ -- | \$ 6,090 | \$ 6,090 |
| Other operating expenses | (3,358,311) | (20,258) | (3,378,569) |
| Interest income | -- | -- | -- |
| Interest expense | (45,934) | -- | (45,934) |
| Settlement expense | (144,527) | -- | (144,527) |
| Recovery of bad debts | -- ----- | 14,168 ----- | 14,168 ----- |
| Segment loss | \$(3,548,772) ===== | \$ -- ===== | \$(3,548,772) ===== |

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September 30, 2003

| | NETWORK TV ----- | NETWORK RADIO ----- | TOTAL ----- |
|--------------------------|----------------------|------------------------|----------------------|
| Assets | \$ 55,373 ===== | \$ -- ===== | \$ 55,373 ===== |
| Revenue | \$ 30,000 | \$ 9,998 | \$ 39,998 |
| Amortization | -- | (10,192) | (10,192) |
| Other operating expenses | (707,070) | (25,010) | (732,080) |
| Interest income | 4,936 | -- | 4,936 |
| Interest expense | (72,255) | -- | (72,255) |
| Settlement expense | (36,500) | -- | (36,500) |
| Recovery of bad debts | -- | 15,012 | 15,012 |
| Minority interest | -- | 5,097 | 5,097 |
| Segment loss | \$(780,889) ===== | \$ (5,095) ===== | \$(785,984) ===== |

NOTE 8 - GOING CONCERN

As reflected in the accompanying consolidated financial statements, the Company had an accumulated deficit of \$6,717,134 and a working capital deficit of \$783,712 at September 30, 2004, and cash used in operations in for the nine months ended September 30, 2004 of \$110,926. Also, revenues were nominal. In addition, the Company defaulted on the \$824,000 loans payable in June 2004 due to non-payment of required interest payments and accordingly the loans became due on demand. Accordingly, the lender may take possession of collateral and may exercise its rights to voting the 56,000,000 collateral common shares. Through November 2003, the Company received approximately \$582,000 in funding, net of \$168,000 of fees. Additionally, through September 30, 2004, the Company borrowed \$824,000 under loan agreements to pay back the debenture holders.

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

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, management is also pursuing potential acquisition/merger situations which may change the

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nature of the business substantially. 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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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

This following information specifies certain forward-looking statements of management of the company. Forward-looking statements are statements that estimate the happening of future events are not based on historical fact. Forward-looking statements may be identified by the use of forward-looking terminology, such as "may", "shall", "could", "expect", "estimate", "anticipate", "predict", "probable", "possible", "should", "continue", or similar terms, variations of those terms or the negative of those terms. The forward-looking statements specified in the following information have been compiled by our management on the basis of assumptions made by management and considered by management to be reasonable. Our future operating results, however, are impossible to predict and no representation, guaranty, or warranty is to be inferred from those forward-looking statements.

The assumptions used for purposes of the forward-looking statements specified in the following information represent estimates of future events and are subject to uncertainty as to possible changes in economic, legislative, industry, and other circumstances. As a result, the identification and interpretation of data and other information and their use in developing and selecting assumptions from and among reasonable alternatives require the exercise of judgment. To the extent that the assumed events do not occur, the outcome may vary substantially from anticipated or projected results, and, accordingly, no opinion is expressed on the achievability of those forward-looking statements. No assurance can be given that any of the assumptions relating to the forward-looking statements specified in the following information are accurate, and we assume no obligation to update any such forward-looking statements.

OVERVIEW

We intended to use the net proceeds from the Debenture to develop, operate and expand the businesses of RTV and Radio X and continue to seek other opportunities for us. In 2004, we entered into loan agreements and borrowed a total of \$824,000 and received net proceeds of \$752,600, net of debt issue costs and paid back the debenture holders \$750,000. We believe that through our loan borrowings, we will have sufficient capital to operate through the end of 2004. We will, however, continue to seek additional capital to fund further development, expansion and operation of our businesses. Upon conversion of the Debentures into our common stock there will be substantial shareholder dilution.

RESULTS OF OPERATIONS

NINE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2003

REVENUES

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Revenues for the nine months ended September 30, 2004 were \$6,090 as compared to revenues for the nine months ended September 30, 2003 of \$39,998 and were derived from our consolidated subsidiary, Radio X Network.

OPERATING EXPENSES

Compensation was \$1,542,708 for the nine months ended September 30, 2004 compared to \$115,986 for the comparable period in 2003. Compensation relates solely to compensation under our employment agreement with our president and additional stock based compensation valued at \$1,410,500 in the third quarter of 2004. Additionally, in May 2004, the Company recorded additional non-cash compensation of \$57,208 due to the issuance of 10,000,000 common shares for accrued compensation.

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Amortization of radio programs of \$0 and \$10,192 for the nine months ended September 30, 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 nine months ended September 30, 2004 was \$1,632,088 compared to \$15,758 for the nine months ended September 30, 2003. During the nine months ended September 30, 2004, consulting expense related to the issuance of common stock for services to outside consultants.

The debenture penalty of \$30,000 and \$427,150 for the nine months ended September 30, 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 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 nine months ended September 30, 2003, the Company had an impairment loss of \$20,910 as compared to \$0 for the nine months ended September 30, 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 nine months ended September 30, 2004 were \$23,478 compared to \$56,853 for the nine months ended September 30, 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 \$110,445 for the nine months ended September 30, 2004 as compared to \$80,487 for the nine months ended September 30, 2003. The increase in expenses is primarily due to an increase in travel related expense for the nine months ended September 30, 2004 as compared to the nine months ended September 30, 2003.

Interest expense was \$45,934 for the nine months ended September 30, 2004 compared to \$72,255 for the nine months ended September 30, 2003. Interest expense is attributed to the loan payable and 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

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to the default on payment.

For the nine months ended September 30, 2004, we recognized settlement expense of \$144,527 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 \$3,548,772 or \$(.03) per share for the nine months ended September 30, 2004 as compared to a net loss of \$785,984 or \$(.03) per share for the nine months ended September 30, 2003.

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LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2004, we had a stockholders' deficit of \$769,289. 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 \$752,600 through May 2004. We also sold 53,000,000 shares of our common stock in a private placement offering in September 2004 for \$132,500. To date, we have received \$70,000 of the proceeds. We expect to receive the additional \$62,500 in the near term. 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 and debentures. During the three months ended June 30, 2004, we repaid \$750,000 of our outstanding convertible debentures. The cash balance at September 30, 2004 was \$553 and we will have to minimize operations until we receive additional cash flows from our businesses, complete additional financing, or find a merger candidate.

We have no other material commitments for capital expenditures. 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 and loan 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.

Net cash used in operations during the nine months ended September 30, 2004 was \$110,926 and was substantially attributable to net loss of \$3,548,772 offset primarily by non-cash stock based expenses of \$3,096,871, settlement expense of \$144,527, non-cash debt discount amortization of \$3,062, amortization of deferred debt issuance costs of \$39,850, and net changes in operating assets and liabilities of \$153,536. In the comparable period of 2003, we had net cash used in operations of \$140,677 primarily relating to the net loss of \$785,984 primarily offset by an impairment loss of \$20,910, stock-based consulting expense of \$36,500, non-cash debt discount amortization of \$12,774, amortization of deferred debt issuance costs of \$10,000, and net changes in operating assets and liabilities of \$555,092.

Net cash provided by financing activities for the nine months ended September 30, 2004 was \$9,600 as compared to net cash provided by financing activities of \$60,299 for the nine months ended September 30, 2003. During the nine months ended September 30, 2004, we received proceeds from loans of \$824,000, received \$7,000 from a stockholder advance, paid debt issuance costs of \$71,400 and repaid debenture holders \$750,000. In the comparable period of 2003, we received a loan from a joint venture partner of \$50,000 and proceeds from an officer loan

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of \$10,999.

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, 2003 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 generate 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.

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

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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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OFF BALANCE SHEET ARRANGEMENTS

There are no off balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

ITEM 3. CONTROLS AND PROCEDURES

As required by SEC rules, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures at the end of the period covered by this report. This evaluation was carried out under the supervision and with the participation of our management, including our principal executive officer and principal financial officer. Based on this evaluation, these officers have concluded that the design and operation of our disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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None

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The Company issued 250,000 shares of common stock to a new member of the board of directors.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

The Company is in default on the \$824,000 loans payable due to non-payment of required interest payments.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

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ITEM 6. EXHIBITS

| REGULATION S-B NUMBER | EXHIBIT |
|--------------------------|--|
| 31 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer and Chief Financial Officer of the Company |
| 32 | Section 906 Certification by Chief Executive Officer and Chief Financial Officer |

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SUN NETWORK GROUP, INC.

November 22, 2004

By: /S/ T. JOSEPH COLEMAN

T. Joseph Coleman
Chief Executive Officer, President, and
Director