

STONEPATH GROUP INC
Form 10-Q
November 09, 2005

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2005

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

For the transition period from _____ to _____

Commission File Number: 001-16105

STONEPATH GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

65-0867684
(I.R.S. Employer
Identification No.)

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2200 Alaskan Way, Suite 200
Seattle, WA 98121
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(206) 336-5400**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

There were 43,712,726 issued and outstanding shares of the registrant's common stock, par value \$.001 per share, at November 4, 2005.

STONEPATH GROUP, INC.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

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STONEPATH GROUP, INC.
Consolidated Balance Sheets

	September 30, 2005		December 31, 2004	
	(UNAUDITED)			
Assets				
Current assets				
Cash and cash equivalents	\$	5,387,335	\$	2,800,645
Accounts receivable, net		72,040,653		64,064,382
Prepaid expenses and other current assets		2,022,179		2,559,858
Total current assets		79,450,667		69,424,885
Goodwill		40,579,684		37,278,661
Technology, furniture and equipment, net		6,862,045		7,595,859
Acquired intangibles, net		5,632,364		7,079,986
Note receivable, related party		87,500		87,500
Other assets		4,070,185		1,479,181
Total assets	\$	136,681,945	\$	122,946,072
Liabilities and Stockholders Equity				
Current liabilities:				
Lines of credit	\$	5,000,000	\$	16,911,700
Note payable		1,897,539		
Accounts payable		49,513,771		38,537,750
Earn-outs payable		2,640,045		2,645,695
Accrued payroll and related expenses		3,509,204		3,192,889
Accrued restructuring costs		2,054,384		741,637
Capital lease obligation		335,419		1,510,461
Accrued expenses		6,158,665		5,627,276
Total current liabilities		71,109,027		69,167,408
Long-term debt		17,916,269		
Other long-term liabilities		161,537		2,064,128
Deferred tax liability		2,189,100		1,650,900
Total liabilities		91,375,933		72,882,436
Minority interest		5,996,022		5,094,336
Commitments and contingencies (Note 8)				
Stockholders equity:				
Preferred stock, \$.001 par value, 10,000,000 shares authorized; none issued				
Common stock, \$.001 par value, 100,000,000 shares authorized; issued and outstanding: 43,712,726 and 42,839,795 shares at 2005 and 2004, respectively		43,713		42,840
Additional paid-in capital		223,933,281		221,728,796
Accumulated deficit		(184,932,667)		(176,806,892)
Accumulated other comprehensive income		265,663		35,856
Deferred compensation				(31,300)
Total stockholders equity		39,309,990		44,969,300
Total liabilities and stockholders equity	\$	136,681,945	\$	122,946,072

See accompanying notes to consolidated financial statements.

STONEPATH GROUP, INC.
Consolidated Statements of Operations
(UNAUDITED)

	Three months ended September 30,				Nine months ended September 30,			
	2005		2004		2005		2004	
Total revenue	\$	111,311,674	\$	109,711,414	\$	301,328,275	\$	256,405,516
Cost of transportation		87,971,539		84,638,366		235,451,678		195,515,923
Net revenue		23,340,135		25,073,048		65,876,597		60,889,593
Personnel costs		11,805,255		13,600,160		35,395,425		36,628,969
Other selling, general and administrative costs		7,985,747		8,608,533		26,266,035		22,080,720
Depreciation and amortization		1,163,778		1,039,742		3,460,457		3,023,520
Restructuring charges						3,448,209		
Income (loss) from operations		2,385,355		1,824,613		(2,693,529)		(843,616)
Other income (expense):								
Loan refinancing costs		(911,998)				(911,998)		
Interest expense, net		(871,469)		(174,924)		(2,004,697)		(269,967)
Provision for excess earn-out payments								(3,075,190)
Other income (expense), net		(3,838)		(33,865)		74,828		(69,149)
Income (loss) from continuing operations before income tax expense and minority interest		598,050		1,615,824		(5,535,396)		(4,257,922)
Income tax expense		481,016		964,061		1,688,693		1,607,532
Income (loss) from continuing operations before minority interest		117,034		651,763		(7,224,089)		(5,865,454)
Minority interest		296,584		545,996		901,686		1,098,032
Income (loss) from continuing operations		(179,550)		105,767		(8,125,775)		(6,963,486)
Loss from discontinued operations, net of tax				(50,000)				(50,000)
Net income (loss)	\$	(179,550)	\$	55,767	\$	(8,125,775)	\$	(7,013,486)
Basic and diluted income (loss) per common share -								
Continuing operations	\$		\$		\$	(0.19)	\$	(0.17)
Discontinued operations								
Basic and diluted income (loss) per common share	\$		\$		\$	(0.19)	\$	(0.17)
Basic weighted average shares outstanding		43,712,726		41,352,322		43,550,871		40,099,518
Diluted weighted average shares and share equivalents outstanding		43,712,726		45,773,006		43,550,871		40,099,518

See accompanying notes to consolidated financial statements.

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STONEPATH GROUP, INC.
Consolidated Statements of Cash Flows
(UNAUDITED)

	Nine months ended September 30,	
	2005	2004
Cash flow from operating activities:		
Net loss	\$ (8,125,775)	\$ (7,013,486)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Deferred income taxes	538,200	363,000
Depreciation and amortization	3,460,457	3,023,520
Minority interest in income of subsidiaries	901,686	1,098,032
Stock-based compensation	31,300	42,474
Loss (Gain) on disposal of technology, furniture and equipment and other	(57,436)	8,350
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(7,976,271)	(13,880,578)
Prepaid expenses and other assets	48,483	378,987
Accounts payable and accrued expenses	13,259,122	10,092,245
Net cash provided by (used in) operating activities	2,029,766	(5,887,456)
Cash flows from investing activities:		
Purchases of technology, furniture and equipment	(1,049,534)	(4,070,129)
Payment of earn-out	(2,452,125)	(3,431,285)
Proceeds from sales of technology, furniture and equipment	129,390	
Acquisition of business, net of cash acquired		(6,837,119)
Loans made		(75,000)
Net cash used in investing activities	(3,372,269)	(14,413,533)
Cash flows from financing activities:		
Proceeds from line of credit, net	6,004,569	18,119,900
Principal payments on capital lease	(1,245,655)	(551,670)
Payment of debt issuance costs	(1,109,528)	
Proceeds from issuance of common stock upon exercise of options and warrants		1,782,819
Net cash provided by financing activities	3,649,386	19,351,049
Effect of foreign currency translation	229,807	47,919
Net increase (decrease) in cash and cash equivalents	2,586,690	(902,021)
Cash and cash equivalents at beginning of period	2,800,645	3,074,151
Cash and cash equivalents at end of period	\$ 5,387,335	\$ 2,172,130
Cash paid for interest	\$ 1,834,892	\$ 305,215
Cash paid for income taxes	\$ 61,597	\$ 98,602
Supplemental disclosure of non-cash investing and financing activities:		
Issuance of common stock in connection with acquisitions	\$ 854,548	\$ 100,000
Issuance of common stock in connection with Employee Stock Purchase Plan	57,089	224,170
Issuance of warrants in connection with loan refinancing	1,293,721	
Increase in goodwill related to accrued earn-out payments	2,300,000	
Issuance of warrants for consulting services		70,000

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Increase in technology, furniture and equipment and capital lease obligation	390,754
Increase in common stock from conversion of Series D convertible preferred stock	149
Issuance of common stock in connection with exercise of options	511,068

See accompanying notes to consolidated financial statements.

STONEPATH GROUP, INC.
Notes to Unaudited Consolidated Financial Statements
September 30, 2005

(1) Nature of Operations and Basis of Presentation

Stonepath Group, Inc. and subsidiaries (the Company) is a non-asset based third-party logistics services company providing supply chain solutions on a global basis. A full range of time-definite transportation and distribution solutions is offered through the Company's Domestic Services platform, where the Company manages and arranges for the movement of raw materials, supplies, components and finished goods for its customers. These services are offered through the Company's domestic air and ground freight forwarding business. A full range of international logistics services including international air and ocean transportation as well as customs house brokerage services is offered through the Company's International Services platform. In addition to these core service offerings, the Company also provides a broad range of value added supply chain management services, including warehousing, order fulfillment and inventory management. The Company services a customer base of manufacturers, distributors and national retail chains through a network of owned offices in North America and Puerto Rico, strategic locations in Asia, South America and Europe, and service partners strategically located around the world.

The accompanying unaudited consolidated financial statements were prepared in accordance with United States generally accepted accounting principles for interim financial information. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC) relating to interim financial statements. These statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly the Company's financial position, operations and cash flows for the periods indicated. While the Company believes that the disclosures presented are adequate to make the information not misleading, these unaudited consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2004. Interim operating results are not necessarily indicative of the results for a full year because our operating results are subject to seasonal trends when measured on a quarterly basis. Our first and second quarters are likely to be weaker as compared with our other fiscal quarters, which we believe is consistent with the operating results of other supply chain service providers.

The Company has experienced losses from operations, and has an accumulated deficit. In addition the Company has experienced negative cash flow from operations in earlier years. In view of these matters, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon profitable future operations of the Company and generation of cash flow sufficient to meet its obligations. The Company believes that operating improvement and cost reduction actions implemented in the first half of 2005 coupled with existing availability on its credit facilities will provide the Company with adequate liquidity to provide uninterrupted support for its business operations through at least September 30, 2006.

Certain amounts for prior periods have been reclassified in the consolidated financial statements to conform to the classification used in 2005.

(2) Restructuring Charges

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In November 2004, the Company commenced a restructuring program, engineered to accelerate the integration of its businesses and improve the Company's overall profitability. Currently, the Company has consolidated its corporate headquarters and is in the process of consolidating its domestic and international divisional headquarters into one central management facility in Seattle, Washington. This streamlining will eliminate unnecessary duplication of efforts as well as provide a much more cohesive day-to-day management coordination capability and improved internal controls. In addition, the restructuring initiative included the rationalization of technology systems, personnel and facilities throughout the U.S. In connection with this plan, the Company recorded pre-tax restructuring charges of \$3,448,209 during the

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six-month period ended June 30, 2005. No additional restructuring charges were recorded during the three-month period ended September 30, 2005. A summary of 2005 restructuring charges, cash payments and related liabilities is as follows:

	Liability Balance, January 1, 2005	Restructuring Charges	Cash Payments	Liability Balance, September 30, 2005
Personnel	\$ 666,408	\$ 657,289	\$ (978,497)	\$ 345,200
Lease terminations:				
Building	75,229	2,200,010	(566,055)	1,709,185
Equipment		590,910	(590,910)	
	\$ 741,637	\$ 3,448,209	\$ (2,135,462)	\$ 2,054,384

Personnel charges primarily relate to contractual obligations incurred in 2005 with certain executives. Lease termination costs relate to vacating certain Domestic facilities, vacating and relocating the Company's former corporate headquarters in Philadelphia, and the disposal of related leased equipment. All restructuring charges will result in cash payments in future periods through 2008. The Company does not expect to incur additional restructuring costs during the remainder of 2005.

(3) Loan Refinancing Costs

As more fully discussed in Note (7), on August 31, 2005, the Company completed a refinancing of its \$25,000,000 U.S. revolving credit facility. In connection with this transaction, the Company incurred a charge of \$911,998, reflecting payment of a prepayment fee and the expensing of previously deferred loan issue costs.

(4) Stock-Based Compensation

As permitted by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, the Company has elected to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Accordingly, compensation cost for stock options granted to employees and members of the board of directors is measured as the excess, if any, of the quoted market price of the Company's common stock at the date of the grant over the amount the grantee must pay to acquire the stock. The Company accounts for stock-based compensation to non-employees (including directors who provide services outside their capacity as members of the board) in accordance with SFAS No. 123 and Emerging Issues Task Force (EITF) Issue No. 96-18, *Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. The table below illustrates the effect on net income or loss and income or loss per common share as if the fair value of options granted had been recognized as compensation expense in accordance with the provisions of SFAS No. 123.

	Three months ended September 30,				Nine months ended September 30,			
	2005		2004		2005		2004	
Net income (loss):								
As reported	\$	(179,550)	\$	55,767	\$	(8,125,775)	\$	(7,013,486)
								22,174

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Add: stock-based employee compensation expense included in reported net loss								
Deduct: total stock-based compensation expense determined under fair value method for all awards		(61,694)		(1,051,036)		(1,837,482)		(4,147,125)
Pro forma net loss	\$	(241,244)	\$	(995,269)	\$	(9,963,257)	\$	(11,138,437)
Basic and diluted loss per common share:								
As reported	\$		\$		\$	(0.19)	\$	(0.17)
Pro forma		(0.01)		(0.02)		(0.23)		(0.28)

In December 2004, the Financial Accounting Standards Board issued its final standard on accounting for share-based payments, SFAS 123R (Revised 2004), *Share-Based Payment*. SFAS 123R requires companies to expense the fair value of employee stock options and other similar awards. When measuring the fair value of these awards, companies can choose from two different pricing models that reflect their specific circumstances and the economics of their transactions. The Company is in the process of selecting one of three transition methods available under SFAS 123R. Accordingly, the Company has not yet determined the impact on its consolidated financial statements of adopting SFAS 123R. In April 2005, the SEC adopted a new rule which delayed the date for compliance with SFAS 123R. The new effective date for the Company is January 1, 2006.

(5) Acquisitions

On February 9, 2004, the Company acquired, through its indirect wholly-owned subsidiary, Stonepath Holdings (Hong Kong) Limited, a 55% interest in Shaanxi Sunshine Cargo Services International Co., Ltd. (Shaanxi). Shaanxi is a Class A licensed freight forwarder headquartered in Shanghai, PRC and provides a wide range of customized transportation and logistics services and supply chain solutions, including global freight forwarding, warehousing and distribution, shipping services and special freight handling. As consideration for the purchase, which was effective as of March 1, 2004, the Company paid \$3,500,000 in cash, financed through its revolving credit agreement, and 630,915 shares of the Company's common stock which had a value of \$2,000,000 on the date of the transaction. The common shares issued in the transaction were subject to a one-year restriction on sale and were subject to a pro rata forfeiture based upon a formula that compares the actual pre-tax income of Shaanxi through December 31, 2004 with the targeted level of income of \$4,000,000 (on an annualized basis). Also, if the trading price of the Company's common stock was less than \$3.17 per share at the end of the one-year restriction, the Company could issue up to 169,085 additional shares to the seller. Because the common shares issued in connection with this transaction were subject to forfeiture, they were accounted for as contingent consideration. Based upon the actual pre-tax income through December 31, 2004, the seller forfeited 37,731 shares of common stock. As provided for in the purchase agreement, the amount of \$119,608, which represents the original fair value of the forfeited shares at the date of acquisition, will be added ratably to the future earn-outs. Because the quoted market price of the Company's common stock was less than \$3.17 on February 9, 2005, the Company issued 158,973 additional shares of its common stock. As of February 9, 2005, the Company had issued 752,157 shares of its common stock in connection with this transaction. The Company recorded additional goodwill amounting to \$752,157 in the first quarter of 2005. The seller may receive additional consideration of up to \$5,619,608 under an earn-out arrangement payable at the rate of \$1,100,000 in the first year and \$1,129,902 per year over the next four years based on the future financial performance of Shaanxi.

In addition, the Company agreed to pay the seller 55% of Shaanxi's accounts receivable balances, net of assumed liabilities, existing on the date of acquisition realized in cash within 180 days following the acquisition with a targeted distribution date in August 2004. Effective September 20, 2004, the Company amended the purchase agreement for a change in the settlement date from August 2004 to an initial payment of \$1,045,000 on or before November 15, 2004, and the final payment of \$868,000 on or before March 31, 2005. The amendment also fixed the date of distribution for collections in cash after the initial 180 day working capital assessment period from being due when collected to March 31, 2005. On March 21, 2005, the Company and the seller entered into a financing arrangement whereby the amount due on March 31, 2005 was extended to March 31, 2006 through the execution of a note between the seller and the Company with interest at 10% per annum. The note balance of \$1,897,539 is classified in current liabilities under the caption note payable in the consolidated balance sheet at September 30, 2005. The note was included in other long-term liabilities in the consolidated balance sheet at December 31, 2004.

The acquisition, which significantly enhances the Company's presence in the region, was accounted for as a purchase and accordingly, the results of operations and cash flows of Shaanxi have been included in the Company's consolidated financial statements prospectively from the date of acquisition. Because the Company consolidates its foreign subsidiaries on a one-month lag, such information has been reflected in the consolidated statement of operations effective for periods subsequent to April 1, 2004. The total purchase price, including acquisition expenses of \$269,000, was \$7,402,000. The following table

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summarizes the allocation of the purchase price based on the fair value of the assets acquired and liabilities assumed (in thousands):

Current assets	\$	15,090
Furniture and equipment		157
Goodwill		2,913
Other intangible assets		1,453
Total assets acquired		19,613
Current liabilities assumed		(9,727)
Minority interest		(2,484)
Net assets acquired	\$	7,402

The acquired intangible assets have a weighted average life of 6.6 years. The intangible assets include a customer related intangible of \$1,112,100 with a 7.1 year life and a covenant-not-to-compete of \$341,000 with a five year life. The \$2,913,300 of goodwill was assigned to the Company's International Services business unit and is not deductible for income tax purposes.

The following unaudited pro forma information for the nine months ended September 30, 2004 is presented as if the acquisition of Shaanxi had occurred on December 1, 2003, using the one month lag consolidation policy (in thousands, except earnings per share):

	Nine months ending September 30, 2004	
Total revenue	\$	280,961
Net loss		(6,275)
Loss per share:		
Basic and diluted	\$	(0.15)

(6) Acquired Intangible Assets

Information with respect to acquired intangible assets is as follows:

	September 30, 2005				December 31, 2004			
		Gross Carrying Amount		Accumulated Amortization		Gross Carrying Amount		Accumulated Amortization
Amortizable intangible assets:								
Customer related	\$	11,042,100	\$	6,062,418	\$	11,042,100	\$	4,813,229
Covenants-not-to-compete		1,506,000		853,318		1,506,000		654,885
Total	\$	12,548,100	\$	6,915,736	\$	12,548,100	\$	5,468,114

Aggregate amortization expense:

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For the three-months ended September 30, 2005	\$	454,706
For the three-months ended September 30, 2004		584,614
For the nine-months ended September 30, 2005		1,438,659
For the nine-months ended September 30, 2004		1,707,234

Estimated aggregate amortization expense:

For the remainder of the year ended December 31, 2005	\$ 420,000
For the year ended December 31, 2006	1,547,000
For the year ended December 31, 2007	1,254,000
For the year ended December 31, 2008	931,000
For the year ended December 31, 2009	607,000
For the year ended December 31, 2010	482,000

(7) Revolving Credit Facilities

U.S. Credit Facility

On August 31, 2005, the Company entered into several agreements with Laurus Master Fund, Inc. (Laurus), to provide a new \$25,000,000 U.S. revolving credit facility (U.S. Facility) which replaced its previous revolving credit facility held by Zohar II 2005-1, Limited, an affiliate of Patriarch Partners, LLC (Patriarch). In connection with establishing the U.S. Facility with Laurus, the Company entered into two principal borrowing agreements and a warrant agreement, the terms of which are as follows:

Secured Convertible Minimum Borrowing Note (Minimum Borrowing Note) The Minimum Borrowing Note has a principal amount of \$10,000,000, has a three-year term expiring August 31, 2008 and bears interest at prime plus 1% subject to a minimum interest rate of 5.5%. The Minimum Borrowing Note is convertible into the Company's common stock at a conversion price of \$1.08 per share subject to customary antidilution adjustments. A total of 9,259,259 shares of the Company's common stock would be issued upon the full conversion of the principal of the Minimum Borrowing Note. Assuming the Company has registered the shares necessary to complete the full conversion of the Minimum Borrowing Note, and if the market price of the Company's common stock for the last five trading dates of any month exceeds the conversion price of \$1.08 per share by 25%, then the interest rate for the next month will be reduced by 200 basis points for each incremental 25% increase in market price above \$1.08.

In the event that the Minimum Borrowing Note has been converted in full into the Company's common stock and there remains at least \$11,000,000 outstanding under the U.S. Facility, then a new Minimum Borrowing Note will be issued. The terms of the new Minimum Borrowing Note would be the same as the initial note except for the conversion price, which would be 115% of the average closing price of the Company's common stock for the ten trading days immediately prior to the date of the issuance of a new Minimum Borrowing Note, but in no event greater than 120% of the closing price of the Company's common stock on such date.

Secured Revolving Note (Revolving Note) The Revolving Note covers borrowing outstanding under the facility that are not represented by the Minimum Borrowing Note. The Revolving Note has a three-year term expiring August 31, 2008 and bears interest at prime plus 3.5% subject to a floor of 8.0% and prepayment premiums of 3% in the first year, 2% in the second year, and 1% in the third year of the Revolving Note.

Common Stock Purchase Warrants (Warrant) The Warrant entitles Laurus to purchase 2,500,000 shares of the Company's common stock for a period of five years, at an exercise price that varies with the number of shares purchased under the Warrant. The exercise price is \$1.13 for the first 900,000 shares, \$1.41 for the next 700,000 shares, \$4.70 for the next 450,000 shares and \$7.52 for the remaining 450,000 shares. The Warrants were recorded at their fair value of \$1,293,721, as measured using the Black-Scholes option-pricing model. The Warrants are included in other assets on the consolidated balance sheet and are being amortized to interest expense over the three-year term of the Facility on a straight line-basis.

The level of eligible accounts receivable of the Company limits the amounts available to be borrowed under the Minimum Borrowing Note and Revolving Note. The U.S. Facility generally provides for an advance rate of 90% of eligible accounts receivable. The U.S. Facility does not contain financial covenants

although it does have affirmative and negative covenants, including the requirement for consent from the lender for certain actions, including future acquisitions, the payment of cash dividends or a merger. The Minimum Borrowing Note and Revolving Note are further secured by a global security interest in substantially all the assets of the Company's domestic subsidiaries, excluding any stock held in a foreign subsidiary.

To complete the transaction, the Company paid a loan fee to Laurus of \$875,000, which is included in other assets and is being amortized to expense over the term of the facility. Additionally, prepayment fees due upon early termination of the previous domestic credit facility and expensing of previously capitalized loan issue costs resulted in a charge of \$911,998 being recorded during the three-months ended September 30, 2005.

As of September 30, 2005, the Company had \$10,000,000 outstanding under Minimum Borrowing Note and \$7,916,269 outstanding under the Revolving Note. Based on the level of eligible receivables there was additional borrowing availability of \$2,080,000 under the Revolving Note.

In April and May 2005, the Company had amended its previous credit facility to assign the facility's interest to Patriarch in addition to making changes to other key terms, including changes to certain restrictive covenants. As noted above, the agreement with Laurus replaced this amended facility.

Offshore Credit Facility

In October, 2004, a subsidiary of the Company, Stonepath Holdings (Hong Kong) Limited (Asia Holdings) entered into a Term Credit Agreement with Hong Kong League Central Credit Union (the Lender) and SBI Advisors, LLC, as agent for the Lender. The Term Credit Agreement provided Asia Holdings with the right to borrow an initial amount of \$3,000,000 and up to an additional \$7,000,000 upon the satisfaction of certain conditions. Asia Holdings borrowed \$3,000,000 on November 4, 2004 and \$2,000,000 on February 16, 2005. The borrowings under the Term Credit Agreement were secured by floating charges on the foreign accounts receivable of three of its subsidiaries, Planet Logistics Express (Singapore) Pte. Ltd., G-Link Express (Singapore) Pte. Ltd., and Stonepath Logistics (Hong Kong) Limited. All borrowings under the Term Credit Agreement bore interest at an annual rates of between 12% and 15% and were to be repaid on or before November 4, 2005. Stonepath Group, Inc. has guaranteed the obligations of Asia Holdings under the Term Credit Agreement. The outstanding balance on the Term Credit Agreement was \$5,000,000 at September 30, 2005.

On October 26, 2005 the Company exchanged \$3,000,000 of principal outstanding under the Term Credit Agreement for 30,000 newly issued preferred shares of Asia Holdings and extended the maturity date for the repayment of \$1,000,000 of the remaining \$2,000,000 outstanding principal under the Term Credit Agreement to November 4, 2007. The preferred shares are convertible into the Company's common stock at a conversion price of \$1.08 per share. Dividends on the preferred shares accumulate at a rate of 12% payable monthly in cash or, at the option of the Company, payable in additional preferred shares. A total of 2,777,778 shares of the Company's common stock would be issued upon the full conversion of the preferred shares, assuming dividends are paid in cash. The remaining \$1,000,000 due under the Term Credit Agreement would be unsecured, bear interest at an annual rate of 12%, and previous security provided through floating rate charges would be released. No additional borrowing availability exists under the Term Credit Agreement. The Company also issued warrants to the Lender entitling the holders to purchase 277,778 shares of the Company's common stock at an exercise price of \$1.13 for a period of four years. The Company does not anticipate that these warrants will have a material affect on the Company's financial position or results of operations at the time of issuance.

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The Company was named as a defendant in eight purported class action complaints filed in the United States Court for the Eastern District of Pennsylvania between September 24, 2004 and November 19, 2004. Also named as defendants in these lawsuits were officers Dennis L. Pelino and Thomas L. Scully and former officer Bohn H. Crain. These cases were consolidated for all purposes in that Court under the caption In re Stonepath Group, Inc. Securities Litigation, Civ. Action No. 04-4515 and the lead plaintiff, Globis Capital Partners, LP, filed an amended complaint in February 2005. The lead plaintiff seeks to

represent a class of purchasers of the Company's shares between March 29, 2002 and September 20, 2004, and alleges claims for securities fraud under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. These claims were based upon the allegation that certain public statements made during the period from March 29, 2002 through September 20, 2004 were materially false and misleading because they failed to disclose that the Company's Domestic Services operations had improperly accounted for accrued purchased transportation costs. The plaintiffs sought compensatory damages, attorneys' fees and costs, and further relief as may be determined by the Court. The Company and the individual defendants believe that this action was without merit, have filed a motion to dismiss this action and intend to vigorously defend against the claims raised in this action. On October 27, 2005, the Court granted the defendants' motion to dismiss the plaintiff's complaint with leave to file an amended complaint.

The Company was named as a nominal defendant in a shareholder derivative action on behalf of the Company that was filed on October 12, 2004 in the United States District Court for the Eastern District of Pennsylvania under the caption Ronald Jeffrey Neer v. Dennis L. Pelino, et al., Civ. A. No. 04-cv-4971. Also named as defendants in the action were all of the individuals who were serving as directors of the Company when the complaint was filed (Dennis L. Pelino, J. Douglas Coates, Robert McCord, David R. Jones, Aloysius T. Lawn and John H. Springer), former directors Andrew Panzo, Lee C. Hansen, Darr Aley, Stephen George, Michela O'Connor-Abrams and Frank Palma, officer Thomas L. Scully and former officers Bohn H. Crain and Stephen M. Cohen. The derivative action alleged breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, unjust enrichment and violations of the Sarbanes-Oxley Act of 2002. These claims were based upon the allegation that the defendants knew or should have known that the Company's public filings for fiscal years 2001, 2002 and 2003 and for the first and second quarters of fiscal year 2004, and certain press releases and public statements made during the period from January 1, 2001 through August 9, 2004, were materially misleading. The complaint alleged that the statements were materially misleading because they understated the Company's accrued purchase transportation liability and related costs of transportation in violation of generally accepted accounting principles and they failed to disclose that the Company lacked internal controls. The derivative action sought compensatory damages in favor of the Company, attorneys' fees and costs, and further relief as may be determined by the Court. The Court granted the defendants' motion to dismiss this action on September 27, 2005 and the plaintiff has filed a notice of appeal on October 26, 2005. The Company and the individual defendants believe that the action was without merit and intend to vigorously defend against the claims raised in this action.

On October 22, 2004, Douglas Burke filed a two-count action against United American Acquisitions, Inc. (UAF), Stonepath Logistics Domestic Services, Inc., and the Company in the Circuit Court for Wayne County, Michigan. Mr. Burke is the former President and Chief Executive Officer of UAF. The Company purchased the stock of UAF from Mr. Burke on May 30, 2002 pursuant to a Stock Purchase Agreement. At the closing of the transaction Mr. Burke received \$5.1 million and received the right to receive an additional \$11.0 million in four annual installments based upon UAF's performance in accordance with the Stock Purchase Agreement. Subject to the purchase, Stonepath Logistics Domestic Services, Inc. and Mr. Burke entered into an Employment Agreement. Mr. Burke's complaint alleges that the defendants breached the terms of the Employment Agreement and Stock Purchase Agreement and seeks, among other things, the production of financial information, unspecified damages, attorney's fees and interest. In early October 2005, the Wayne County Circuit Court granted the defendant's motion to dismiss the lawsuit and to compel arbitration. The court ordered, and the parties agreed, to submit the issues concerning the plaintiff's objections regarding the earn-out calculation under the Stock Purchase Agreement to a national accounting firm and to submit plaintiff's claim relating to the Employment Agreement and defendant's counterclaims to a different neutral arbitrator. The defendants believe that Mr. Burke's claims are without merit and intend to vigorously defend against them. In addition, the Company is seeking \$456,000 in excess earn-out payments that were paid to Mr. Burke.

The Company has received notice that the Securities and Exchange Commission (Commission) is conducting an informal inquiry to determine whether certain provisions of the federal securities laws have been violated in connection with the Company's accounting and financial reporting in connection with the restatement of the Company's financial statements for the years ended December 31, 2001, 2002 and 2003 and the first two quarters of 2004. As part of the inquiry, the staff of the Commission has requested information relating to the restatement amounts, personnel at the Air Plus subsidiary and Stonepath Group,

Inc. and additional background information for the period from October 5, 2001 to December 2, 2004. The Company is voluntarily cooperating with the staff.

The Company is not able to predict the outcome of any of the foregoing actions at this time, since each action is in an early stage. An adverse determination in any of those actions could have a material and adverse effect on the Company's financial position, results of operations and/or cash flows.

The Company is also involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of those matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity. No accruals have been established for any pending legal proceedings.

(9) Stockholders' Equity

In connection with the December 2003 acquisition of the Malaysia operations of the G Link Group, the Company agreed to pay \$102,000, as additional consideration on a post-closing basis, for net assets acquired amounting to \$102,000 through the issuance of common stock. In May 2005, 41,757 shares of the Company's common stock were issued to complete this transaction.

In connection with the Shaanxi acquisition, as of February 9, 2005 the Company had issued 752,157 shares of its common stock. Because the ultimate number of shares issued in connection with the transaction were contingent on the financial performance of Shaanxi through December 31, 2004, and the trading price of the Company's common stock on February 9, 2005, such shares were not reflected as outstanding securities in the accompanying consolidated financial statements for periods prior to February 9, 2005. As discussed in Note (5), 630,915 shares were originally designated for issuance with this transaction as of the date of acquisition and 121,242 shares were issued upon ultimate completion of all contingent matters.

Stock option activity for the nine months ended September 30, 2005 included the grant to an employee of 30,000 options to purchase common shares at a price of \$0.70 per share. The option price was the trading price of the Company's common stock on the date of the grant. Additionally, 467,406 options were cancelled during the first nine-months of 2005.

As discussed in Note (7), in connection with entering into a new loan facility, 2,500,000 warrants were issued on August 31, 2005 at various exercise prices between \$1.13 and \$7.52 per share and were recorded at a fair value of \$1,293,721. Additionally, 1,208,784 warrants expired during the first nine-months of 2005 relating to warrants issued prior to 2005.

On April 29, 2005, 79,016 shares of common stock were issued to satisfy obligations to employees under the Company's Employee Stock Purchase Plan.

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During the nine-month period ended September 30, 2004, holders converted 149,293 shares of the Company's Series D Preferred Stock into 1,492,930 shares of the Company's common stock.

(10) Earnings (Loss) per Share

Basic earnings (loss) per common share and diluted earnings (loss) per common share are presented in accordance with SFAS No. 128, Earnings per Share. Basic earnings (loss) per common share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted earnings (loss) per common share incorporates the incremental shares issuable upon the assumed exercise of stock options, warrants and convertible securities if dilutive. Dilutive shares for the three-month period ended September 30, 2004 were 4,420,684. The inclusion of these dilutive shares did not cause diluted earnings per share to differ from basic earnings per share for this period. Certain stock options, warrants and convertible securities were excluded from the calculation of diluted earnings (loss) per common share because their effect was antidilutive. The total number of such shares excluded from diluted earnings (loss) per common share are 12,892,847 and 9,628,684 for the three-month periods ended September 30, 2005 and 2004, respectively and 11,463,372 and 8,777,902 for the nine-month periods ended September 30, 2005 and 2004, respectively.

Also, the 630,915 shares of common stock issued in connection with the Shaanxi acquisition were subject to pro rata forfeiture based upon the financial performance of Shaanxi through December 31, 2004. Accordingly, such shares have been excluded from the calculation of basic and diluted loss per common share for the three- and nine-month periods ended September 30, 2004.

(11) Income Taxes

The components of income tax expense consist of the following:

	Three months ended September 30,				Nine months ended September 30,			
	2005		2004		2005		2004	
U.S. federal	\$	155,400	\$	105,200	\$	466,200	\$	315,600
State		37,505		76,137		156,999		156,737
Foreign		288,111		782,724		1,065,494		1,135,195
	\$	481,016	\$	964,061	\$	1,688,693	\$	1,607,532

The Company has accumulated net operating losses (NOLs). Due to the uncertainty surrounding the realization of the NOLs, the Company has placed a valuation allowance on its deferred tax assets. Income tax expense for the three- and nine-month periods ended September 30, 2005 and 2004 resulted primarily from non-U.S.-based earnings, state income taxes and deferred income taxes arising from the amortization of goodwill for income tax purposes.

(12) Related Party Transactions

The Company, through its Shaanxi subsidiary, advanced \$416,000 to the principal minority shareholder of Shaanxi, who is also a current officer. The advance is repayable, at the Company's option, in cash or by the contribution to Shaanxi of 100% of the stock in a newly opened Taiwan logistics company currently owned by that individual. The Company has a note payable outstanding to this minority shareholder amounting to \$1,897,539 in connection with the acquisition of Shaanxi as discussed in Note 5.

(13) Segment Information

SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance. The Company identifies operating segments based on the principal service provided by the business unit. Each segment has a separate management structure. The accounting policies of the reportable segments are the same as described in our Annual Report on Form 10-K for the year ended December 31, 2004. Segment information, in which corporate expenses have been fully allocated to the operating segments, is as follows (in thousands):

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	Three months ended September 30, 2005							
	Domestic Services		International Services		Corporate		Total	
Revenue from external customers	\$	29,672	\$	81,640	\$		\$	111,312
Intersegment revenue		100		55				155
Segment operating income		1,036		1,349				2,385

	Three months ended September 30, 2004							
	Domestic Services		International Services		Corporate		Total	
Revenue from external customers	\$	37,822	\$	71,889	\$		\$	109,711
Intersegment revenue		4		123				127
Segment operating income (loss)		(823)		2,648				1,825

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	Nine months ended September 30, 2005							
	Domestic Services		International Services		Corporate		Total	
Revenue from external customers	\$	91,608	\$	209,720	\$		\$	301,328
Intersegment revenue		175		162				337
Segment operating income (loss)		(4,862)		2,170				(2,694)
Segment assets		40,177		90,614		5,891		136,682
Segment goodwill		19,731		20,849				40,580

	Nine months ended September 30, 2004							
	Domestic Services		International Services		Corporate		Total	
Revenue from external customers	\$	105,685	\$	150,720	\$		\$	256,405
Intersegment revenue		14		217				231
Segment operating income (loss)		(4,816)		3,973				(844)
Segment assets		43,642		68,941		12,086		124,669
Segment goodwill		19,641		14,823				34,464

The revenue in the table below is allocated to geographic areas based upon the location of the customer (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2005		2004		2005		2004	
Total revenue:								
United States	\$	57,930	\$	70,285	\$	170,974	\$	178,281
Asia		49,239		35,815		118,331		65,761
North America (excluding the United States)		97		190		350		1,128
Europe		2,020		2,051		5,686		5,900
South America		1,236		807		4,149		2,697
Other		790		563		1,838		2,638
Total	\$	111,312	\$	109,711	\$	301,328	\$	256,405

The following table presents long-lived assets by geographic area (in thousands):

	September 30,			
	2005		2004	
United States	\$	5,965	\$	10,106
Asia		771		663
South America		112		114
Europe		14		
Total long-lived assets	\$	6,862	\$	10,883

Cash held with foreign banks amounted to \$5,607,000 at September 30, 2005.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement For Forward-Looking Statements

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This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, regarding future results, levels of activity, events, trends or plans. We have based these forward-looking statements on our current expectations and projections about such future results, levels of activity, events, trends or plans. These forward-looking statements are not guarantees and are subject to known and unknown risks, uncertainties and assumptions about us that may cause our actual results, levels of activity, events, trends or plans to be materially different from any future results, levels of activity, events, trends or plans expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, would, expect, plan, anticipate, believe, estimate, negative of such terms or other similar expressions. While it is impossible to identify all of the factors that may cause our actual results, levels of activity, events, trends or plans to differ materially from those set forth in such forward-looking statements, such factors include the inherent risks associated with: (i) our ability to sustain an annual growth rate in revenue consistent with recent results, (ii) our ability to achieve our targeted operating margins, (iii) our ability to realize the planned benefits from our restructuring efforts, (iv) our dependence on certain large customers, (v) our dependence upon certain key personnel, (vi) an unexpected adverse result in any legal proceeding, (vii) competition in the freight forwarding, logistics and supply chain management industry, (viii) the impact of current and future laws affecting the Company's operations, (ix) adverse changes in general economic conditions as well as economic conditions affecting the specific industries and customers we serve, (x) regional disruptions in transportation, and (xi) other factors which are or may be identified from time to time in our Securities and Exchange Commission filings and other public announcements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date made. We undertake no obligation to publicly release the result of any revision of these forward-looking statements to reflect events or circumstances after the date they are made or to reflect the occurrence of unanticipated events.

OVERVIEW

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We are a non-asset based third-party logistics services company providing supply chain solutions on a global basis. We offer a full range of time-definite transportation and distribution solutions through our Domestic Services platform, where we manage and arrange the movement of raw materials, supplies, components and finished goods for our customers. These services are offered through our domestic air and ground freight forwarding business. We also offer a full range of international logistics services, including international air and ocean transportation as well as customs house brokerage services, through our International Services platform. In addition to these core services, we provide a broad range of value-added supply chain management services, including warehousing, order fulfillment and inventory management solutions. We serve a customer base of manufacturers, distributors and national retail chains through a network of offices in 22 major metropolitan areas in North America, Puerto Rico, 17 locations in Asia, six locations in Brazil and one location in Europe, as well as an extensive network of independent carriers and service partners strategically located around the world.

Our objective is to build a leading global logistics services organization that integrates established operating businesses and innovative technologies. To that end, we are extending our network through a combination of synergistic acquisitions and the organic expansion of our existing base of operations.

Our acquisition strategy focuses on acquiring and integrating logistics businesses that will enhance operations within our current market areas as well as extend our network to targeted locations in Asia, South America, Europe and the Middle East. We select acquisition targets based upon their ability to demonstrate: (1) historic levels of profitability; (2) a proven record of delivering superior time-definite distribution and other value-added services; (3) an established customer base of large and mid-sized companies; and (4) opportunities for significant growth within strategic segments of our business.

As we integrate these companies, we intend to create additional stockholder value by: (1) improving productivity by adopting enhanced technologies and business processes; (2) improving transportation margins by leveraging our growing purchasing power; (3) enhancing the opportunity for organic growth by cross-selling and offering expanded services; and (4) implementing standard management reporting systems.

We have completed, to date, the acquisition of 16 logistics companies and are currently working to improve profitability by further consolidating and rationalizing our facilities and personnel within the U.S. Our existing domestic credit facility requires the lender's consent for further acquisitions. If and when our acquisition program is resumed, we do not expect it to continue at its historic pace because of our desire to optimize and fully integrate new acquisitions into our existing facilities, personnel and services.

Our strategy is designed to take advantage of shifting market dynamics. The third-party logistics industry continues to grow as an increasing number of businesses outsource their logistics functions to more cost effectively manage and extract value from their supply chains. Also, we believe the industry is positioned for further consolidation since it remains highly fragmented, and since customers are demanding the types of sophisticated and broad reaching services that can more effectively be handled by larger and more diverse organizations.

Our principal source of income is derived from freight forwarding services. As a freight forwarder, we arrange for the shipment of our customers' freight from point of origin to point of destination. Generally, we quote our customers a turn key cost for the movement of their freight. Our price quote will often depend upon the customer's time-definite needs (next day through fifth day delivery), special handling needs (heavy equipment, delicate items, environmentally sensitive goods, electronic components, etc.) and the means of transport (truck, air, ocean or rail). In turn, we assume the responsibility for arranging and paying for the underlying means of transportation.

We also provide a range of other services including customs brokerage, warehousing and other value added services, which include customized distribution, fulfillment, and other value added supply chain services.

Total revenue represents the total dollar value of services we sell to our customers. Our cost of transportation includes direct costs of transportation, including motor carrier, air, ocean and rail services. We act principally as the service provider to add value in the execution and procurement of these services to our customers. Our net transportation revenue (gross transportation revenue less the direct cost of transportation) is the primary indicator of our ability to source, add value and resell services provided by third parties, and is considered by management to be a key performance measure. We believe that net revenue is also an important measure of economic performance. Net revenue includes transportation revenue and our fee-based activities, after recognizing the cost of transportation. In addition, management believes measuring its operating costs as a function of net revenue provides a useful metric, as our ability to control costs as a function of net revenue directly impacts operating earnings.

A majority of our revenue is derived from our international operations, and the growth of those operations is an important part of our business strategy. Our current international operations are focused principally on the shipment of goods into and out of the United States and Asia and are dependent on the volume of international trade with the United States. Our strategic plan contemplates the growth of those operations, as well as the expansion into the transportation of goods wholly outside of the United States. The following factors could adversely affect our current international operations, as well as the growth of those operations:

the political and economic systems in certain international markets are less stable than in the United States;

wars, civil unrest, acts of terrorism and other conflicts exist in certain international markets;

export restrictions, tariffs, licenses and other trade barriers can adversely affect the international trade serviced by our international operations;

managing distant operations with different local market conditions and practices is more difficult than managing domestic operations;

differing technology standards in other countries present difficulties and expense in integrating our services across international markets;

complex foreign laws and treaties can adversely affect our ability to compete; and

our ability to repatriate funds may be limited by foreign exchange controls.

Our operating results will be affected as acquisitions occur. Since all acquisitions are made using the purchase method of accounting for business combinations, our consolidated financial statements will only include the results of operations and cash flows of acquired companies for periods subsequent to the dates of acquisition. To help facilitate the consolidation, analysis and public reporting process, our offshore operations are included within our consolidated results on a one-month lag, as such, our third quarter includes results from our offshore operations for the period June 1 through August 31. As a result of the one-month lag, the operating results of Shaanxi were first reflected in our consolidated financial statements beginning in April 2004.

Our net income will also be affected by non-cash charges relating to the amortization of customer-related intangible assets and other intangible assets arising from our completed acquisitions. Under applicable accounting standards, purchasers are required to allocate the total consideration in a business combination to the identified assets acquired and liabilities assumed based on their fair values at the time of acquisition. The excess of the consideration paid over the fair value of the identifiable net assets acquired is to be allocated to goodwill, which is tested at least annually for impairment. Applicable accounting standards require the Company to separately account for and value certain identifiable intangible assets based on the unique facts and circumstances of each acquisition. As a result of the Company's acquisition strategy, our net income will include material non-cash charges relating to the amortization of customer related intangible assets and other intangible assets acquired in our acquisitions.

Our operating results are also subject to seasonal trends when measured on a quarterly basis. Our first and second quarters are likely to be weaker as compared with our other fiscal quarters, which we believe is consistent with the operating results of other supply chain service providers. This trend is dependent on numerous factors, including the markets in which we operate, holiday seasons, consumer demand and economic conditions. Since our revenue is largely derived from customers whose shipments are dependent upon consumer demand and just-in-time production schedules, the timing of our revenue is often beyond our control. Factors such as shifting demand for retail goods and/or manufacturing production delays could unexpectedly affect the timing of our revenue. As we increase the scale of our operations, seasonal trends in one area may be offset to an extent by opposite trends in another area. We cannot accurately predict the timing of these factors, nor can we accurately estimate the impact of any particular factor, and thus we can give no assurance that historical seasonal patterns will continue in future periods.

CRITICAL ACCOUNTING POLICIES

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Our accounting policies, which are in compliance with accounting principles generally accepted in the United States, require us to apply methodologies, estimates and judgments that have a significant impact on the results we report in our financial statements. In our Annual Report on Form 10-K for the year ended December 31, 2004 we have discussed those policies that we believe are critical and require the use of complex judgment in their application. Since December 31, 2004, there have been no material changes to our critical accounting policies.

RESULTS OF OPERATIONS

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Quarter ended September 30, 2005 compared to quarter ended September30, 2004

The following table summarizes our total revenue, net transportation revenue and other revenue (in thousands):

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	Quarter ended September 30,				Change		
	2005		2004		Amount	Percentage	
Total revenue	\$	111,312	\$	109,711	\$	1,601	1.5%
Transportation revenue	\$	105,380	\$	103,999		1,381	1.3
Cost of transportation		87,971		84,638		3,333	3.9
Net transportation revenue		17,409		19,361		(1,952)	(10.1)
<i>Net transportation margin</i>		16.5%		18.6%			
Customs brokerage		1,889		1,683		206	12.2
Warehousing and other value added services		4,042		4,029		13	0.3
Total net revenue	\$	23,340	\$	25,073	\$	(1,733)	(6.9)%
<i>Net revenue margin</i>		21.0%		22.9%			

Total revenue was \$111.3 million in the third quarter of 2005, an increase of 1.5% or \$1.6 million over total revenue of \$109.7 million in the third quarter of 2004. There were no domestic or international acquisitions in 2005 or 2004 affecting the quarterly comparability of year over year results. The Domestic Services platform recorded \$29.7 million in total revenue for the third quarter of 2005, a decline of \$8.2 million or 21.7% compared to \$37.9 million recorded in the same period of 2004. The decline in Domestic Services total revenue was due to lower automotive related business caused by the difficult economic conditions of domestic automobile manufacturers and reduced volume from a major customer. The decline in revenue from this major customer, which was approximately \$7.2 million less in the third quarter of 2005 than was recorded in the third quarter of 2004, resulted from the customer selling a line of business we serviced and realigning a distribution program to an in-house operation. The International Services platform recognized \$81.6 million in total revenue for the third quarter of 2005, a year over year improvement of \$9.8 million or 13.7%. International Services experienced a strong revenue increase in its Asia businesses, which offset a decline of \$2.4 million in its U.S. recorded international revenues during the third quarter. The revenue increase in the third quarter was achieved despite a labor strike at the primary carrier that services our China operations and resulted in certain volumes being diverted to other freight forwarders. Growth is attributable to increases in volume from existing customers and development of new customer relationships.

Net transportation revenue was \$17.4 million in the third quarter of 2005, a decrease of 10.1% compared to net transportation revenue of \$19.4 million in the third quarter of 2004. The Domestic Services platform recorded \$8.0 million in net transportation revenue for the third quarter of 2005, a decrease of \$0.9 million or 9.9% over the same prior year period. The International Services platform recognized \$9.4 million in net transportation revenue for the third quarter of 2005, a year over year decline of \$1.1 million or 10.3%. We estimate this negative impact of the strike on our net transportation revenue to be \$750,000 in the third quarter of 2005.

Net transportation margins decreased to 16.5% for the third quarter of 2005 from 18.6% for the third quarter of 2004. For the third quarter of 2005, net transportation margins for the Domestic Services platform increased to 30.6% from 25.8% in the same period in 2004. Domestic margins were favorably impacted by price increases implemented during the first nine months of 2005 and reductions of less profitable business. For the International Services platform, net transportation margins declined to 11.8% in the third quarter of 2005 from 15.0% in the same period in 2004. The decline in International Services margin was attributable to several factors, including higher costs resulting from a labor strike at an airline that provides significant lift capacity for our Asia export business. While we continued to service business through the time of the strike, we were forced to pay higher airline rates which couldn't be fully recovered from our customers. Further, our margins on new and existing business tend to be lower due to competitive pricing pressures.

Net revenue was \$23.3 million in the third quarter of 2005, a decrease of 6.9% over net revenue of \$25.1 million in the third quarter of 2005. The Domestic Services platform delivered \$11.3 million in net revenue for the third quarter of 2005, a 7.3% decline compared to the \$12.3 million in net revenue recorded in the third quarter of 2004. The International Services platform delivered \$12.0 million in net revenue for the third quarter of 2005, a year over year decline of \$0.8 million or 6.5%.

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Net revenue margins decreased to 21.0% for the third quarter of 2005 compared to 22.9% for the same prior year period. Net revenue margins for Domestic Services improved to 38.3% from 32.3%. For the International Services platform, net transportation margins declined to 14.7% from 17.9%.

The following table compares certain consolidated statement of operations data as a percentage of our net revenue (in thousands):

	2005		2004		Change	
	Amount	Percent	Amount	Percent	Amount	Percent
Net revenue	\$ 23,340	100.0%	\$ 25,073	100.0%	\$ (1,733)	(6.9)%
Personnel costs	11,805	50.6	13,600	54.3	(1,795)	(13.2)
Other selling, general and administrative costs	7,986	34.2	8,608	34.3	(622)	(7.2)
Depreciation and amortization	1,164	5.0	1,040	4.1	124	11.9
Total operating costs	20,955	89.8	23,248	92.7	(2,293)	(9.9)
Income from operations	2,385	10.2	1,825	7.3	(560)	(30.7)
Loan refinancing costs	(912)	(3.9)			(912)	NM
Other income (expense), net	(875)	(3.7)	(209)	(0.9)	(666)	NM
Income from continuing operations before income tax expense and minority interest	598	2.6	1,616	6.4	(1,018)	(63.0)
Income tax expense	481	2.1	964	3.8	(483)	(50.1)
Income from continuing operations before minority interest	117	0.5	652	2.6	(535)	(82.1)
Minority interest	297	1.3	546	2.2	(249)	(45.8)
Income (loss) from continuing operations	(180)	(0.8)	106	0.4	(286)	NM
Loss from discontinued operations, net of tax			(50)	(0.2)	50	NM
Net income (loss)	\$ (180)	(0.8%)	\$ 56	0.2%	\$ (236)	NM

Personnel costs were \$11.8 million for the third quarter of 2005, a decrease of 13.2% from \$13.6 million recorded in the third quarter of 2004. The decrease in personnel costs is attributable to lower U.S. personnel costs and lower temporary labor requirements to support Domestic Services business. This decrease was offset by additional costs incurred to support new International Services business. Personnel costs as a percentage of net revenue decreased to 50.6% in the third quarter of 2005 from 54.3% in the third quarter of 2004. Compared to September 30, 2004, headcount decreased by 5.0% or 59 employees to a total of 1,119. Headcount has also decreased 4.3% or 50 employees since December 31, 2004. We have been aggressively rationalizing our U.S. operations, including our employment level, as part of our previously announced restructuring program.

Other selling, general and administrative costs were \$8.0 million for the third quarter of 2005, a decrease of 7.2% compared to \$8.6 million recorded in the third quarter of 2004. This decrease is primarily due to lower facilities, equipment, and continued management focus on lowering costs to improve profitability. As a percentage of net revenue, other selling, general and administrative costs decreased to 34.2% in the third quarter of 2005 from 34.3% in the third quarter of 2004.

Depreciation and amortization was \$1.2 million in the third quarter of 2005, compared to \$1.0 million recorded in the third quarter of 2004. Higher depreciation levels are primarily due to increases in technology related capital expenditures for information systems placed in service since the fourth quarter of 2004. Depreciation and

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amortization as a percentage of net revenue increased to 5.0% in the third quarter of 2005 from 4.1% in the third quarter of 2004.

As a result of the matters above, income from operations was \$2.4 million in the third quarter of 2005, as compared to income of \$1.8 million in the third quarter of 2004. While sequential improvement has taken place in operating performance since the first quarter of 2005 and the same period a year ago, we are continuing to pursue opportunities to grow the business, improve net revenue margins and lower costs.

In connection with refinancing our U.S. revolving credit facility we incurred a charge of \$0.9 million, reflecting payment of a prepayment fee and the expensing of previously deferred loan issue costs.

Other income (expense) principally consists of interest expense. Interest expense for the third quarter of 2005 was \$0.9 million compared to \$0.2 million in the third quarter of 2004. The increase in expense was due to higher average borrowings in the U.S. and Asia used to fund operating and investing activities coupled with higher average interest rates contained in the revolving credit agreements we had in place during the quarter. Average borrowing levels were affected by our Asia borrowings, which did not exist in the prior year.

Income tax expense for the third quarter of 2005 was \$0.5 million compared to \$1.0 million in the third quarter of 2004. A portion of our tax expense is associated with earnings from our overseas operations. The foreign income tax provision decreased to \$0.3 million in the third quarter of 2005 compared to \$0.8 million in the third quarter of 2005 due to lower non U.S. based earnings. The balance is due to state income taxes and deferred income taxes resulting from the amortization of goodwill for income tax purposes. We have accumulated U.S. federal net operating losses and had carryforwards of approximately \$47.0 million as of December 31, 2004 which will expire beginning 2018 through 2024.

Net loss was \$180,000 in the third quarter of 2005, compared to a net income of \$56,000 in the third quarter of 2004. Basic and diluted income per common share amounts were zero for the third quarter of 2005, the same as was reported in the third quarter of 2004.

Nine months ended September 30, 2005 compared to nine months ended September 30, 2004

The following table summarizes our total revenue, net transportation revenue and other revenue (in thousands):

	Nine months ended September 30,				Change	
	2005		2004		Amount	Percentage
Total revenue	\$	301,328	\$	256,405	\$ 44,923	17.5%
Transportation revenue	\$	282,787	\$	239,633	43,154	18.0
Cost of transportation		235,452		195,516	39,936	20.4
Net transportation revenue		47,335		44,117	3,218	7.3
<i>Net transportation margin</i>		<i>16.7%</i>		<i>18.4%</i>		
Customs brokerage		6,067		6,784	(717)	(10.6)
Warehousing and other value added services		12,475		9,988	2,487	24.9

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Total net revenue	\$	65,877	\$	60,889	\$	4,988	8.2%
Net revenue margin		21.9%		23.7%			

Total revenue was \$301.3 million in the first nine months of 2005, an increase of 17.5% over total revenue of \$256.4 million in the first nine months of 2004. \$46.6 million of growth in total revenue was primarily attributable to acquisitions made in China and South America in the first quarter of 2004, with same store revenues declining \$1.7 million. The Domestic Services platform recorded \$91.6 million in total revenue for the first nine months of 2005, a decline of 13.3% compared to \$105.7 million in same period in 2004. There were no domestic acquisitions in 2005 or 2004 affecting the comparability of this platform's results. The decline in Domestic Services total revenue was

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due to lower automotive related business caused by the difficult economic conditions of domestic automobile manufacturers and reduced volume from a major customer. The decline in revenue from this major customer, which was approximately \$13.9 million less in the first nine months of 2005 than was recorded in the same period of 2004, resulted from the customer selling a line of business we serviced and realigning a distribution program to an in-house operation. The International Services platform recognized \$209.7 million in total revenue for the first nine months of 2005, a year over year improvement of \$59.7 million or 39.2%, with \$12.4 million of the increase coming from same store growth and the remaining \$46.6 million improvement attributed to our acquisitions.

Net transportation revenue was \$47.3 million in the first nine months of 2005, an increase of 7.3% over net transportation revenue of \$44.1 million in the first nine months of 2004. \$1.1 million, or 32.8% of the increase in net transportation revenue, was attributable to same store growth with \$2.1 million, or 67.2% of the increase, attributable to acquisitions. The Domestic Services platform recorded \$22.9 million in net transportation revenue for the first nine months of 2005, a decline of 3.9% when compared to \$23.8 million recorded in the first nine months of 2004. The International Services platform recognized \$24.4 million in net transportation revenue for the first nine months of 2005, a year over year improvement of \$4.2 million or 20.5%, with \$2.0 million of the increase resulting from same store growth and the remaining \$2.2 million improvement attributed to acquisitions. Net transportation revenue was negatively impacted by a labor strike in China that resulted in higher transport cost to provide alternative lift capacity and diversion of customer volumes to other forwarders. We estimate the impact on net transportation revenue was \$750,000 in the third quarter of 2005.

Net transportation margins decreased to 16.7% for the first nine months of 2005 from 18.4% for the same period in 2004. For the first nine months of 2005, net transportation margins for the Domestic Services platform improved to 28.2% from 24.6% in the same period a year ago. Domestic margins were favorably impacted by price increases implemented during the first nine months of 2005 on certain significant customer relationships and reductions in less profitable business. For the International Services platform, net transportation margins declined to 12.1% from 14.2% driven primarily by the mix of lower margin business acquired with the Shaanxi transaction, higher transport costs in the third quarter of 2005 resulting from an airline labor strike in China, coupled with competitive pressures which have lowered margins on existing and new business.

Net revenue was \$65.9 million in the first nine months of 2005, an increase of 8.2% over net revenue of \$60.9 million in the first nine months of 2004. \$2.9 million, or 57.9% of the increase in net revenue, was attributable to same store growth, with \$2.1 million, or 42.1% of the increase, attributable to acquisitions. The Domestic Services platform delivered \$33.3 million in net revenue for the first nine months of 2005, a 2.5% increase over the \$32.5 million in net revenue recorded in the first nine months of 2004. The International Services platform recorded \$32.6 million in net revenue for the first nine months of 2005, a year over year improvement of \$4.2 million or 15.2%, with \$2.1 million of the increase resulting from same store growth and the remaining \$2.1 million improvement attributed to acquisitions.

Net revenue margins decreased to 21.9% for the first nine months of 2005 compared to 23.7% for the same prior in the year period. Net revenue margins for Domestic Services improved to 36.3% from 30.7%. The International Services platform net transportation margins declined to 15.5% from 18.8%.

The following table compares certain consolidated statement of operations data as a percentage of our net revenue (in thousands):

	Nine months ended September 30,							
	2005				2004			
	Amount	Percent	Amount	Percent	Change		Amount	Percent
Net revenue	\$ 65,877	100.0%	\$ 60,889	100.0%	\$ 4,988		7.6%	
Personnel costs	35,395	53.7	36,629	60.2	(1,234)		(3.4)	
	26,267	39.9	22,080	36.3	4,187		19.0	

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Other selling, general and administrative costs						
Depreciation and amortization	3,461	5.3	3,024	4.9	437	14.5
Restructuring charges	3,448	5.2			3,448	NM
Total operating costs	68,571	104.1	61,733	101.4	6,838	11.1
Loss from operations	(2,694)	(4.1)	(844)	(1.4)	(1,850)	(219.2)
Loan refinancing costs	(912)	(1.4)			(912)	NM
Provision for excess earn-out payments			(3,075)	(5.1)	3,075	NM
Other income (expense), net	(1,929)	(2.9)	(339)	(0.5)	(1,590)	(469.0)
Loss from continuing operations before income tax expense and minority interest						
	(5,535)	(8.4)	(4,258)	(7.0)	(1,277)	(30.0)
Income tax expense	1,689	(2.6)	1,607	2.6	82	5.1
Loss from continuing operations before minority interest						
	(7,224)	(11.0)	(5,865)	(9.6)	(1,359)	(23.2)
Minority interest	902	1.4	1,098	1.8	196	(17.9)
Loss from continuing operations						
	(8,126)	(12.4)	(6,963)	(11.4)	(1,163)	(16.7)
Loss from discontinued operations						
			(50)	(0.1)	50	NM
Net loss	\$ (8,126)	(12.4)%	\$ (7,013)	(11.5)%	\$ (1,113)	(13.7)%

Personnel costs were \$35.4 million for the first nine months of 2005, a decrease of 3.4% compared to \$36.6 million recorded in the first nine months of 2004. \$1.5 million of incremental personnel costs were attributable to costs assumed as part of our acquisition program with the remaining decline of \$2.7 million attributable to restructuring efforts afforded our U.S. operations and lower volumes in our Domestic Services platform. Personnel costs as a percentage of net revenue decreased to 53.7% in the first nine months of 2005 from 60.2% in the first nine months of 2004. Compared to September 30, 2004, headcount decreased by 5.0% or 59 employees to a total of 1,119. Headcount has also decreased 4.3% or 50 employees since December 31, 2004. We have been aggressively rationalizing our U.S. operations, including our employment level, as part of our previously announced restructuring program.

Other selling, general and administrative costs were \$26.3 million for the first nine months of 2005, an increase of 19.0% over \$22.1 million for the same period of 2004. \$1.2 million of the increase is attributable to incremental costs assumed as part of our acquisition program with the remaining \$2.9 million attributable to increased costs of the base business. Negatively impacting this category of expense were approximately \$1.0 million in higher legal, technology and Sarbanes-Oxley and audit related expenses incurred in the first quarter of 2005. As a percentage of net revenue, other selling, general and administrative costs increased to 39.9% in the first nine months of 2005 from 36.3% in the first nine months of 2004.

Depreciation and amortization was \$3.5 million in the first nine months of 2005, an increase of 14.5% over \$3.0 million in the first nine months of 2004. Depreciation and amortization as a percentage of net revenue increased to 5.3% in the first nine months of 2005 from 4.9% in the same period of 2004. The increase in this category of expense is due to higher depreciation from technology and equipment assets acquired since the first quarter of 2004.

As part of our restructuring initiative announced in January 2005 we have rationalized the number of facilities in which we operate and the level of employment in the U.S. We had completed the majority of this initiative as of the end of the second quarter of 2005 but continue to pursue opportunities to reduce costs while maintaining a high level of service to our customers. Restructuring charges recorded in the first nine months of 2005 due to this initiative were \$3.4 million. We do not anticipate incurring additional restructuring charges during the balance of 2005.

In connection with refinancing our U.S. revolving credit facility in the third quarter of 2005, we incurred a charge of \$0.9 million, reflecting payment of a prepayment fee and adjustments to previously deferred loan issue costs.

The provision for excess earn-out payments recorded in the first quarter of 2004 represented a valuation adjustment for amounts paid to former shareholders of acquired companies that, as a result of the restatement of our financial performance for 2003, was in excess of the amount that would have been paid out based upon the restated financial results for 2003. Due to differing interpretations between the Company and the selling shareholders of the earn-out provisions of the purchase agreements, we determined that the resulting receivable from the former shareholders should be fully reserved. If in the future, excess amounts paid are recovered, those proceeds would be reflected as other income in our consolidated statement of operations.

Other income (expense) principally consists of interest expense. Interest expense for the first nine months of 2005 was \$2.1 million compared to \$0.3 million in the comparable period of 2004. The increase in expense was due to higher average borrowings in the U.S. and Asia used to fund operating and investing activities coupled with higher interest rates contained in our revolving credit agreements we had in place for the majority of 2005. Average borrowings were also affected by our Asia borrowings, which did not exist in the prior year.

Income tax expense for the first nine months of 2005 was \$1.7 million compared to \$1.6 million in the first nine months of 2004. A portion of our tax expense is associated with earnings from our overseas operations. The foreign income tax provision amounted to \$1.1 million or 63.1% of the consolidated income tax provision. The balance is due to state income taxes and deferred income taxes resulting from the amortization of goodwill for income tax purposes. We have accumulated U.S. federal net operating losses and had carryforwards of approximately \$47.0 million as of December 31, 2004.

Net loss was \$8.1 million in the first nine months of 2005, compared to a net loss of \$7.0 million in the first nine months of 2004. Basic loss per common share was \$0.19 for the first nine months of 2005 compared to a basic net loss of \$0.17 per common share for the same period in 2004.

FINANCIAL OUTLOOK

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We anticipate our gross revenues will be in excess of \$400 million in 2005. While we were pleased with the sequential improvement in our second and third quarter operating performance in comparison to the first quarter of 2005, we continue to look for opportunities to grow the business, improve net revenue margins and reduce costs while maintaining a high level of service to our customers.

LIQUIDITY AND CAPITAL RESOURCES

As we approach the next stage of our development, we need to augment our capital structure by obtaining additional capital from other sources to provide enhanced flexibility. Additional forms of capital could take the form of subordinated debt, convertible preferred stock and/or common stock, among others. Such enhancements to our capital structure would permit continued expansion. There is no assurance we can raise additional capital from other sources.

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Cash and cash equivalents totaled \$5.4 million and \$2.8 million as of September 30, 2005 and December 31, 2004, respectively. Working capital was \$8.3 million at September 30, 2005 compared to \$0.3 million at December 31, 2004. The increase in working capital was primarily due to a change in classification of borrowings under our revolving credit agreement from a current obligation to a long-term obligation.

Net cash provided by operating activities was \$2.1 million for the first nine months of 2005 compared to cash used of \$5.9 million in the comparable period of 2004. The change was driven principally by improved receivable collections and increases in current payables.

Net cash used in investing activities during the first nine months of 2005 was \$3.4 million compared to \$14.4 million in the first nine months of 2004. Investing activities in 2005 consisted primarily of \$2.5 million in earn-out payments made in relation to 2004 performance targets, and technology related investments. Investing activities in 2004 were driven principally by cash paid in connection with the Shaanxi acquisition, \$4.1 million spent primarily on the development of a technology platform and approximately \$3.4 million in earn-out payments made in relation to 2003 performance targets.

Net cash provided by financing activities during the first nine months of 2005 was approximately \$3.6 million compared to \$19.4 million in the same period of 2004. Financing activities in 2005 consisted of \$6.0 million in proceeds from our lines of credit, debt issuance cost payments of \$1.1 million and capital lease payments of \$1.3 million. Capital lease payments include a \$1.0 million payoff of obligations initially incurred to finance the acquisition of a technology platform. Financing activities in 2004 consisted of \$18.1 million in proceeds from our line of credit and \$1.8 million from the issuance of common stock upon the exercises of options and warrants, offset by principal payments of \$0.6 million on capital leases.