STONEPATH GROUP INC
Form 10-Q/A
February 25, 2005
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A

(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, 2004

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	**65-0867684**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1600 Market Street, Suite 1515 Philadelphia, PA	**19103**
(Address of principal executive offices)	**(Zip Code)**

Registrant s Telephone Number, Including Area Code: (215) 979-8370

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 43,470,710 issued and outstanding shares of the registrant s common stock, par value $.001 per share, at December 30, 2004.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Stockholders and Board of Directors
Stonepath Group, Inc. and Subsidiaries
Philadelphia, Pennsylvania

We have reviewed the accompanying interim consolidated financial statements of Stonepath Group, Inc. and subsidiaries as of September 30, 2004, and for the three-month and nine-month periods then ended. These interim consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

GRANT THORNTON LLP

Minneapolis, Minnesota
February 23, 2005

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Introductory Note

On September 20, 2004, Stonepath Group, Inc. (Stonepath or the Company) announced that its financial statements for 2003 and the first and second quarters of 2004 needed to be restated and should not be relied upon. While that restatement process and the audit work by KPMG, LLP with respect to the Form 10-K/A for the year ended December 31, 2003 were not yet completed, the Company determined that it was in the best interest of the Company to file its quarterly report on Form 10-Q for the period ended September 30, 2004. At that time, the consolidated balance sheet as of December 31, 2003 was unaudited and therefore could not be relied upon by Grant Thornton LLP in connection with their review of the three- and nine-month periods ended September 30, 2004. Accordingly, Grant Thornton LLP had not completed a review of the financial statements in that quarterly report on Form 10-Q as required under Article 10 of Regulation S-X.

On February 11, 2005, the Company filed its Form 10-K/A for the year ended December 31, 2003 which included restated consolidated financial statements as of December 31, 2003 and 2002 and for each of the years in the three-year period ended December 31, 2003. Such financial statements were audited by KPMG LLP which issued its opinion thereon. Grant Thornton LLP has now completed their review of the consolidated financial statements as of and for the three-and nine-month periods ended September 30, 2004. The cautionary statement included in the introductory note to the Company s September 30, 2004 Form 10-Q is hereby removed in this Form 10-Q/A.

Item 1. Financial Statements

STONEPATH GROUP, INC.
Condensed Consolidated Balance Sheets
(UNAUDITED)

	September 30, 2004	December 31, 2003
	Restated (See Note 2)	**Restated (See Note 2)**
Assets		

Current assets:				
Cash	$	2,172,130	$	3,074,151
Accounts receivable, net		65,876,693		38,250,610
Other current assets		2,097,114		2,231,297
Total current assets		70,145,937		43,556,058
Goodwill and acquired intangibles, net		42,063,602		38,284,824
Technology, furniture and equipment, net		10,883,395		7,062,956
Other assets		1,575,694		1,364,917
Total assets	$	124,668,628	$	90,268,755
Liabilities and Stockholders Equity				
Current liabilities:				
Line of credit bank	$	18,119,900	$	
Accounts payable		40,373,073		22,412,287
Accrued expenses		6,609,602		3,797,530
Earn-out payable		117,249		3,548,534
Capital lease obligations		822,678		671,197
Other current liabilities		436,256		
Total current liabilities		66,478,758		30,429,548
Capital lease obligations, net of current portion		822,418		1,134,815
Other long term liabilities		218,125		
Deferred tax liability		1,398,600		1,035,600
Total liabilities		68,917,901		32,599,963
Minority interest		4,754,897		1,345,790
Commitments and contingencies (Note 6)				
Stockholders equity:				
Preferred stock, $.001 par value, 10,000,000 shares authorized; Series D Convertible, issued and outstanding: 161,184 and 310,477 shares at 2004 and 2003, respectively		161		310
Common stock, $.001 par value, 100,000,000 shares authorized; issued and outstanding: 41,227,955 and 37,449,944 shares at 2004 and 2003, respectively		41,228		37,450
Additional paid-in capital		221,730,248		220,067,956
Accumulated deficit		(170,777,023)		(163,763,537)
Accumulated other comprehensive income		49,916		1,997
Deferred compensation		(48,700)		(21,174)
Total stockholders equity		50,995,830		56,323,002
Total liabilities and stockholders equity	$	124,668,628	$	90,268,755

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	Restated (See Note 2)	Restated (See Note 2)	Restated (See Note 2)	Restated (See Note 2)
Total revenue	$ 109,711,414	$ 65,507,874	$ 256,405,516	$ 150,414,213
Cost of transportation	84,638,366	47,554,483	195,515,923	108,581,561
Net revenue	25,073,048	17,953,391	60,889,593	41,832,652
Personnel costs	12,161,930	9,143,082	32,931,229	22,709,180
Other selling, general and administrative costs	10,046,763	5,816,699	25,778,460	16,177,892
Depreciation and amortization	1,039,742	719,536	3,023,520	1,879,765
Litigation settlement and nonrecurring costs		428,837		1,178,837
Income (loss) from operations	1,824,613	1,845,237	(843,616)	(113,022)
Other income (expense)				
Provision for excess earn-out payments			(3,075,190)	(1,270,141)
Interest income	16,468	8,655	29,333	34,456
Interest expense	(191,392)	(130,202)	(299,300)	(130,202)
Other income (expense), net	(33,865)	(93,844)	(69,149)	(35,518)
Income (loss) from continuing operations before income tax expense and minority interest	1,615,824	1,629,846	(4,257,922)	(1,514,427)
Income tax expense	964,061	237,349	1,607,532	542,031
Income (loss) from continuing operations before minority interest	651,763	1,392,497	(5,865,454)	(2,056,458)
Minority interest	545,996	84,546	1,098,032	84,546
Income (loss) from continuing operations	105,767	1,307,951	(6,963,486)	(2,141,004)
Loss from discontinued operations, net of tax	(50,000)		(50,000)	(354,991)
Net income (loss)	$ 55,767	$ 1,307,951	$ (7,013,486)	$ (2,495,995)
Basic earnings (loss) per common share -				
Continuing operations	$	$ 0.04	$ (0.17)	$ (0.08)
Discontinued operations				(0.01)
	$	$ 0.04	$ (0.17)	$ (0.09)

Basic earnings (loss) per common share				
Diluted earnings (loss) per common share -				
Continuing operations	$	$ 0.03	$ (0.17)	$ (0.08)
Discontinued operations				(0.01)
Diluted earnings (loss) per common share	$	$ 0.03	$ (0.17)	$ (0.09)
Basic weighted average shares outstanding	41,352,322	29,435,484	40,099,518	27,553,913
Diluted weighted average shares and share equivalents outstanding	41,352,322	39,918,712	40,099,518	27,553,913

See accompanying notes to unaudited consolidated financial statements.

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

	Nine months ended September 30,	
	2004	2003
	Restated (See Note 2)	Restated (See Note 2)
Cash flows from operating activities:		
Net loss	$ (7,013,486)	$ (2,495,995)
Adjustments to reconcile net loss to net cash used in operating activities:		
Deferred income taxes	363,000	393,600
Depreciation and amortization	3,023,520	1,879,765
Minority interest in income of subsidiaries	1,098,032	84,546
Stock-based compensation	42,474	71,424
Issuance of common stock in litigation settlement		350,000
Discontinued operations issuance of common stock to consultant		135,000
Other	8,350	
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(13,880,578)	(17,881,928)
Other assets	378,987	(730,370)
Accounts payable and accrued expenses	10,092,245	5,905,036
Net cash used in operating activities	(5,887,456)	(12,288,922)
Cash flows from investing activities:		
Purchases of technology and other equipment	(4,070,129)	(3,856,180)
Acquisitions of businesses, net of cash acquired	(6,837,119)	(7,741,378)
Payments of earn-out	(3,431,285)	(2,206,715)
Loans made	(75,000)	(130,000)
Net cash used in investing activities	(14,413,533)	(13,934,273)
Cash flows from financing activities:		
Proceeds from line of credit, net	18,119,900	17,120,869
Issuance of common stock, net of costs		5,632,468
Issuance of common stock upon exercise of options and warrants	1,782,819	293,701
Proceeds from financing of equipment		2,049,638
Sale of minority interest in subsidiary		81,818
Principal payments on capital lease	(551,670)	(94,727)
Net cash provided by financing activities	19,351,049	25,083,767
Effect of foreign currency translation	47,919	
Net decrease in cash and cash equivalents	(902,021)	(1,139,428)
Cash and cash equivalents at beginning of period	3,074,151	2,266,108
Cash and cash equivalents at end of period	$ 2,172,130	$ 1,126,680
Cash paid for interest	$ 305,215	$ 130,202
Cash paid for income taxes	$ 98,602	$

Supplemental disclosure of non-cash investing and financing activities:

Increase in technology, furniture and equipment from capital lease obligation	$	390,754	$	
Increase in common stock from conversion of Series D preferred stock	$	149	$	356
Issuance of warrants for consulting services	$	70,000	$	
Issuance of common stock in connection with cashless exercise of options	$	511,068	$	
Issuance of common stock in connection with acquisitions	$	100,000	$	1,912,468
Issuance of common stock in connection with payment of earn-out	$		$	443,300
Issuance of common stock in connection with employee stock purchase plan	$	224,170	$	
Accrual for payment of acquisitions of net assets of G-Link to be settled in common stock	$		$	1,516,220
Transfer of equipment in satisfaction of interim financing	$		$	703,000
Issuance of common stock in satisfaction of liabilities	$		$	155,250
Private placement costs incurred in prior period	$		$	120,000

See accompanying notes to unaudited consolidated financial statements.

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
September 30, 2004

(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 the movement of raw materials, supplies, components and finished goods for its customers. 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 control. The Company services a diverse customer base including manufacturers, distributors and national retail chains.

The accompanying unaudited consolidated financial statements were prepared in accordance with 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 of normal recurring accruals including adjustments to previously reported amounts in the three- and nine-month periods ended September 30, 2004 and 2003 (see Note 2), 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/A for the year ended December 31, 2003 (see Note 2). 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 in both revenues and earnings when compared with our other fiscal quarters, which we believe is consistent with the operating results of other supply chain service providers.

(2) Restatement

On February 11, 2005, the Company filed its Form 10-K/A for the year ended December 31, 2003 which included restated consolidated financial statements as of December 31, 2003 and 2002 and for each of the years in the three-year period ended December 31, 2003. Those restated consolidated financial statements reflected adjustments to purchased transportation costs, certain revenue transactions, earn-out costs and resultant income tax effects. In connection with the preparation of its consolidated financial statements for the year ended December 31, 2004, the Company has identified certain claims expenses amounting to $251,000 which pertain to the first quarter of 2004, but which were recorded in the fourth quarter of 2004. The accompanying consolidated financial statements as of September 30, 2004 and for the nine-month period then ended have been restated to reflect the effect of that adjustment. The effects of these restatements on previously reported consolidated financial statements as of December 31, 2003 and September 30, 2004 and for the three- and nine-month periods ended September 30, 2004 and 2003, which were included in the Company s Form 10-Q for the period ended September 30, 2004, are summarized below.

	December 31, 2003	
	As Previously Reported	**As Restated**
Select Balance Sheet Data:		
Accounts payable	$ 22,195,646	$ 22,412,287
Total current liabilities	30,212,907	30,429,548
Deferred tax liability	1,295,000	1,035,600
Total liabilities	32,642,722	32,599,963
Accumulated deficit	(163,806,296)	(163,763,537)
Total stockholders equity	56,280,243	56,323,002

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Stonepath Group, Inc.
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September 30, 2004

	September 30, 2004	
	As Previously Reported	As Restated
Select Balance Sheet Data:		
Accrued expenses	$ 6,358,602	$ 6,609,602
Total current liabilities	66,227,758	66,478,758
Deferred tax liability	1,658,000	1,398,600
Total liabilities	68,926,301	68,917,901
Accumulated deficit	(170,785,423)	(170,777,023)
Total stockholders equity	50,987,430	50,995,830

	Three Months Ended September 30, 2004	
	As Previously Reported	As Restated
Select Statement of Operations Data:		
Cost of transportation	$ 85,284,354	$ 84,638,366
Net revenue	24,427,060	25,073,048
Income from operations	1,178,625	1,824,613
Income from continuing operations before income tax expense and minority interest	969,836	1,615,824
Income from continuing operations before minority interest	5,775	651,763
Income (loss) from continuing operations	(540,221)	105,767
Net income (loss)	(590,221)	55,767
Basic loss per common share	$ (0.01)	$
Diluted loss per common share	$ (0.01)	$

	Nine Months Ended September 30, 2004	
	As Previously Reported	As Restated
Select Statement of Operations Data:		
Cost of transportation	$ 195,732,584	$ 195,515,923
Net revenue	60,672,952	60,889,593
Other selling, general and administrative costs	25,527,460	25,778,460
Loss from operations	(809,257)	(843,616)
Loss from continuing operations before income tax expense and minority interest	(4,223,563)	(4,257,922)
Loss from continuing operations before minority interest	(5,831,095)	(5,865,454)
Loss from continuing operations	(6,929,127)	(6,963,486)
Net loss	(6,979,127)	(7,013,486)
Basic loss per common share	$ (0.17)	$ (0.17)
Diluted loss per common share	$ (0.17)	$ (0.17)

	Nine Months Ended September 30, 2004	
	As Previously Reported	As Restated
Select Statement of Cash Flows Data:		

Net loss	$	(6,979,127)	$	(7,013,486)
Other assets		(548,090)		378,987
Accounts payable and accrued expenses		10,984,963		10,092,245

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
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	Three Months Ended September 30, 2003	
	As Previously Reported	As Restated
Select Statement of Operations Data:		
Cost of transportation	$ 47,476,649	$ 47,554,483
Net revenue	18,031,225	17,953,391
Income from operations	1,923,071	1,845,237
Income from continuing operations before income taxes and minority interest	1,707,680	1,629,846
Income tax expenses	268,999	237,349
Income from continuing operations before minority interest	1,438,681	1,392,497
Income from continuing operations	1,354,135	1,307,951
Net income	1,354,135	1,307,951
Basic earnings per common share	$ 0.05	$ 0.04

	Nine Months Ended September 30, 2003	
	As Previously Reported	As Restated
Select Statement of Operations Data:		
Cost of transportation	108,237,527	108,581,561
Net revenue	42,176,686	41,832,652
Income (loss) from operations	231,012	(113,022)
Loss from continuing operations before income taxes and minority interest	(1,170,393)	(1,514,427)
Income tax expense	636,981	542,031
Loss from continuing operations before minority interest	(1,807,374)	(2,056,458)
Loss from continuing operations	(1,891,920)	(2,141,004)
Net loss	(2,246,911)	(2,495,995)
Basic loss per common share:		
Continuing operations	$ (0.07)	$ (0.08)
Loss per common share	$ (0.08)	$ (0.09)
Diluted loss per common share:		
Continuing operations	$ (0.07)	$ (0.08)
Loss per common share	$ (0.08)	$ (0.09)

	Nine Months Ended September 30, 2003	
	As Previously Reported	As Restated
Select Statement of Cash Flows Data:		
Net loss	$ (2,246,911)	$ (2,495,995)
Deferred income taxes	488,550	393,600
Accounts payable and accrued expenses	5,561,002	5,905,036

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
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As a result of the restatements, payments to former owners of certain acquired companies exceeded amounts which would have been due had the adjustments been recorded during the periods restated. The aggregate over payments of $4,345,331 previously recorded as additional goodwill have been eliminated from goodwill. The overpayments of $3,075,190 applicable to 2003 and the $1,270,141 applicable to 2002 have been reclassified to other assets and, because of differing interpretations of the stock purchase agreements by the Company and the selling shareholders, have been fully reserved for; the charge is included in other income (expense) in the consolidated statement of operations for the nine-month periods ended September 20, 2004 and 2003, respectively. The Company intends to pursue repayment which will be recorded as other income if and when received.

(3) Recent 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 $5,500,000 consisting of $3,500,000 in cash, financed through its revolving credit agreement, and $2,000,000 of the Company s common stock. The common shares issued in the transaction are subject to a one-year restriction on sale and are 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 is less than $3.17 per share at the end of the one-year restriction, the Company will issue up to 169,085 additional shares to the seller. Because the common shares issued in connection with this transaction are subject to forfeiture, they are accounted for as additional contingent consideration. When the number of common shares to be retained by the seller is ultimately determined, such shares will be valued at their then fair value and will result in additional goodwill being recorded. In addition, the Company agreed to pay the seller 55% of Shaanxi s accounts receivable balances, net of assumed liabilities (the Effective Date Net Accounts Receivable), 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. As of September 30, 2004, the residual distribution is estimated at $1,028,000 bringing the total estimated March 31, 2005 distribution to $1,896,000. The seller may receive additional consideration of up to an additional $5,500,000

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Stonepath Group, Inc.
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September 30, 2004

under an earn-out arrangement payable at the rate of $1,100,000 per year over a period of five years based on the future financial performance of Shaanxi.

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. At September 30, 2004 the total purchase price, including acquisition expenses of $269,000, but excluding the contingent consideration, was $6,650,000. The following table summarizes the allocation of the purchase price based on fair value of the assets acquired and liabilities assumed at March 1, 2004 (in thousands):

Current assets	$ 15,090
Furniture and equipment	157
Goodwill and other intangible assets	3,614
Total assets acquired	18,861
Current liabilities assumed	(9,727)
Minority interest	(2,484)
Net assets acquired	$ 6,650

The following unaudited pro forma information is presented as if the acquisition of Shaanxi had occurred on December 1, 2002, using the one-month lag consolidation policy (in thousands, except earnings per share):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004 Restated	**2003 Restated**	**2004 Restated**	**2003 Restated**
Revenue	$ 109,711	$ 81,530	$ 280,961	$ 199,747
Income (loss) from continuing operations	124	1,522	(6,225)	(1,190)
Net income (loss)	74	1,522	(6,275)	(1,545)
Earnings per share:				
Basic	$	$ 0.05	$ (0.15)	$ (0.05)
Diluted	$	$ 0.04	$ (0.15)	$ (0.05)

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
September 30, 2004

(4) Stock-Based Compensation

The Company accounts for its employee stock option grants by applying the intrinsic value method. The table below illustrates the effect on net income (loss) and earnings (loss) per common share as if the fair value of options granted had been recognized as compensation expense in accordance with the fair value method.

	Three months ended September 30,				Nine months ended September 30,			
	2004 Restated		**2003 Restated**		**2004 Restated**		**2003 Restated**	
Net income (loss) as reported	$	55,767	$	1,307,951	$	(7,013,486)	$	(2,495,995)
Add: stock-based employee compensation expense included in reported net income (loss), net of tax				23,808		22,174		71,424
Deduct: total stock-based compensation expense determined under the fair value method for all awards, net of tax		(1,051,036)		(465,430)		(4,147,125)		(1,649,329)
Pro forma net income (loss)	$	(995,269)	$	866,329	$	(11,138,437)	$	(4,073,900)
Basic earnings (loss) per common share:								
As reported	$		$	0.05	$	(0.17)	$	(0.09)
Pro forma	$	(0.02)	$	0.03	$	(0.28)	$	(0.15)
Diluted earnings (loss) per common share:								
As reported	$		$	0.03	$	(0.17)	$	(0.09)
Pro forma	$	(0.02)	$	0.02	$	(0.28)	$	(0.15)

(5) Revolving Credit Facility

At September 30, 2004, the Company maintained a $25,000,000 (subsequently amended - see Note 11) revolving credit facility (the Facility) collateralized by the accounts receivable and the other assets of the Company and certain of its subsidiaries (borrowers). The Facility requires the borrowers to meet certain financial objectives and maintain certain financial covenants. Advances under the Facility may be used to finance working capital and other corporate purposes. On July 28, 2004, the Company amended its Facility to provide a bridge term loan with a principal amount of $5,000,000 and a term of 120 days. This loan bears interest at 200 basis points above the prime rate. The amendment modified certain financial covenants, including but not limited to, cash flow coverage ratio test, funded debt limitations and domestic and worldwide funded debt to consolidated EBITDA. At September 30, 2004 the Company had advances of $13,119,900 under the revolving facility plus an additional $5,000,000 drawn under

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
September 30, 2004

the bridge loan facility. The Company repaid the bridge loan facility on November 26, 2004**.** Based upon available collateral, net of advances under the Facility and outstanding letter of credit commitments, there was approximately $3,510,000 available for borrowing under the Facility (as amended) as of January 31, 2005.

As discussed in Note 2, the Company restated its consolidated financial statements. These restated amounts resulted in technical default of certain financial covenants of the Facility. These defaults have been waived and the Company has entered into a further amended revolving credit facility dated November 17, 2004. This amendment reduces the Facility term from May 15, 2007 to January 31, 2006, reduces the maximum availability under the Facility from $25,000,000 to $22,500,000, establishes minimum quarterly EBITDA targets commencing in the quarter ending December 31, 2004, precludes acquisitions, eliminates LIBOR based borrowings, fixes the interest rate at the lender s prime rate plus 200 basis points and imposes semi-annual fees of $125,000 among other changes to the Facility.

(6) Commitments and Contingencies

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 actions were officers Dennis L. Pelino and Thomas L. Scully and former officer Bohn Crain. These cases have now been consolidated for all purposes in that Court under the caption *In re Stonepath Group, Inc. Securities Litigation*, Civ. Action No. 04-4515. The plaintiffs initially sought to represent a class of purchasers of the Company s shares between May 7, 2003 and September 20, 2004, and allege 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 May 7, 2003 through August 9, 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 Court has consolidated the eight lawsuits into a single action and the lead plaintiff has filed an amended complaint. The amended complaint seeks to represent a class of purchasers of the Company s shares between March 29, 2002 and September 20, 2004 based upon public statments made during that period. The Company and the individual defendants believe that the plaintiffs claims are without merit and intend to vigorously defend against them.

The Company has been 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 are 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 alleges breach of fiduciary duty, abuse of control and gross mismanagement, waste of corporate assets, unjust enrichment and violations of the Sarbanes-Oxley Act of 2002. These claims are based upon the allegation that the defendants knew or should have known that the

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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 to the present, were materially misleading because they failed to disclose that the Company s Domestic Services operations had improperly accounted for accrued purchased transportation costs. The derivative action seeks compensatory damages in favor of the Company, the recovery of bonuses and incentive-based or equity-based compensation received by Mr. Pelino and Mr. Crain from 2001 through 2004, restitution, attorneys fees and costs, and further relief as may be determined by the Court. The defendants believe that this action is without merit, have filed a motion to dismiss this action, and intend to vigorously defend themselves against the claims raised in this action.

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. 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.

On May 6, 2003, the Company elected to settle litigation instituted on August 20, 2000 by Austost Anstalt Schaan, Balmore Funds, S.A. and Amro International, S.A. Although the Company believed that the plaintiffs claims were without merit, the Company chose to settle the matter in order to avoid future litigation costs and to mitigate the diversion of management s attention from operations. The total settlement costs of $750,000, paid $400,000 in cash and $350,000 in shares of the Company s common stock, are included in the accompanying unaudited and restated consolidated statement of operations for the nine-month period ended September 30, 2003.

The Company settled the suit brought by Emergent Capital Investment LLC in the United States District Court for the Southern District of New York in exchange for the payment by the Company of $50,000. The settlement is included in loss from discontinued operations in the consolidated statements of operations for the three- and nine-month periods ended September 30, 2004.

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. The defendants believe that Mr. Burke s claims are without merit and intend to vigorously defend against them.

Victoria Tkach, a former employee of UAF and Stonepath Logistics Domestic Services, Inc. has filed a complaint against Stonepath Logistics Domestic Services, Inc., the Company, and UAF seeking damages in excess of $75,000 and relief from her covenant not to compete. The complaint alleges sexual harassment and retaliation by the defendants. The defendants believe that Ms. Tkach s claims are without merit and intend to vigorously defend against them.

The Company may become involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company s consolidated financial position, results of operations or liquidity.

(7) Stockholders Equity

Common Stock

On March 6, 2003, the Company completed a private placement of 4,470,000 shares of its common stock. The transaction consisted of the sale of 4,270,000 shares at $1.35 per share and 200,000 shares at $1.54 per share. In connection with this transaction, the Company realized

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gross proceeds of $6,072,500, paid a brokerage fee consisting of cash commissions of $364,350, issued placement agent warrants to purchase 297,000 shares of common stock at an exercise price of $1.49 per share, and incurred other cash expenses of $33,677. In addition, the Company had previously paid the placement agent $25,000 in cash and had issued it warrants to purchase 150,000 shares of common stock at an exercise price of $1.23 per share.

In connection with the Shaanxi acquisition, the Company issued 630,915 shares of its common stock. Because these shares are subject to a pro rata forfeiture based on the financial performance of Shaanxi through December 31, 2004, such shares have not been reflected as outstanding securities in the accompanying consolidated financial statements.

Series D Convertible Preferred Stock

There are 161,184 shares of Series D Preferred Stock outstanding as of September 30, 2004.

Each share of the Series D Convertible Preferred Stock is convertible into ten shares of common stock of the Company. The holders of the Series D Convertible Preferred Stock are entitled to participate in all liquidation distributions made to the holders of the Company s common stock on an as-if converted basis. The Series D Convertible Preferred Stock carries no dividend, and, except under limited circumstances, has no voting rights except as required by law. The Series D Convertible Preferred Stock automatically converts into shares of the Company s common stock as of December 31, 2004.

During the nine months ended September 30, 2004, 149,293 shares of the Company s Series D preferred stock were converted into 1,492,930 shares of the Company s common stock.

Stock Options and Warrants

The following summarizes the Company s stock option activity and related information:

	Shares	Range of exercise prices	Weighted average exercise price
Outstanding at January 1, 2004	10,604,134	$ 0.50 17.50	$ 1.36
Granted	2,724,700	1.65 3.75	2.82
Exercised	(2,089,094)	0.60 1.81	0.85
Cancelled	(505,306)	1.30 2.50	1.92
Outstanding at September 30, 2004	10,734,434	$ 0.50 17.50	$ 1.80

The Company received and cancelled 170,579 shares of its common stock in connection with a cashless exercise on June 22, 2004. The Company received and cancelled 154,417 shares of its common stock in connection with a cashless exercise on July 19, 2004. On August 23, 2004, the Company received and cancelled 170,602 shares of its common stock in connection with a cashless exercise.

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The following summarizes the Company s stock warrant activity and related information:

	Shares	Range of exercise prices	Weighted average exercise price
Outstanding at January 1, 2004	1,883,396	$ 1.00 1.49	$ 1.03
Granted	600,000	5.00	5.00
Exercised	(525,612)	1.00	1.00
Outstanding at September 30, 2004	1,957,784	$ 1.00 5.00	$ 2.26

(8) Earnings (Loss) 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 and warrants and upon the assumed conversion of the Company s preferred stock, if dilutive. Certain stock options, stock warrants, and convertible securities were excluded from the calculation of diluted earnings (loss) per share because their effect was antidilutive. The total numbers of such shares excluded from the diluted earnings (loss) per common share calculations are 9,628,684 and 229,600 for the three months ended September 30, 2004 and 2003, respectively, and 8,777,902 and 9,537,312 for the nine months ended September 30, 2004 and 2003, respectively. Also, the 630,915 shares of common stock issued in connection with the Shaanxi acquisition are 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 earnings (loss) per common share for the three- and nine-month periods ended September 30, 2004.

(9) Income Taxes

The components of income tax expense consist of the following:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003 Restated	2004	2003 Restated
Current:				
Federal	$	$	$	$
State	60,337	10,000	109,337	30,000
Foreign	782,724	96,149	1,135,195	118,431
	843,061	106,149	1,244,532	148,431
Deferred				
Federal	105,200	112,200	315,600	336,600
State	15,800	19,000	47,400	57,000
Foreign				
	121,000	131,200	363,000	393,600
	$ 964,061	$ 237,349	$ 1,607,532	$ 542,031

As a result of historical losses related to investments in early-stage technology businesses which are unrelated to the Company's current activities and the Company's rapid expansion, the Company has accumulated net operating losses (NOL's). Due to the uncertainty surrounding the realization of the NOL's, 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, 2004 and 2003 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.

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(10) Segment Information

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/A for the year ended December 31, 2003. Segment information, in which corporate expenses (other than the litigation settlement in 2003) have been fully allocated to the operating segments, is as follows (in thousands):

Three months ended September 30, 2004

	Restated Domestic Services	International Services	Corporate	Restated Total
Revenue from external customers	$ 37,822	$ 71,889	$	$ 109,711
Intersegment revenue	4	123		127
Income (loss) from operations	(1,739)	3,564		1,825

Three months ended September 30, 2003

	Restated Domestic Services	International Services	Corporate	Restated Total
Revenue from external customers	$ 39,900	$ 25,608	$	$ 65,508
Intersegment revenue	7	41		48
Income (loss) from operations	(333)	2,607	(429)	1,845

Nine months ended September 30, 2004

	Restated Domestic Services	International Services	Corporate	Restated Total
Revenue from external customers	$ 105,685	$ 150,720	$	$ 256,405
Intersegment revenue	14	217		231
Income loss) from operations	(6,523)	5,679		(844)
Segment assets	43,642	68,941	12,086	124,669
Segment goodwill and intangibles, net	23,462	18,602		42,064

Nine months ended September 30, 2003

	Restated Domestic Services	International Services	Corporate	Restated Total

Revenue from external customers	$ 87,735	$ 62,679	$	$ 150,414
Intersegment revenue	47	98		145
Income (loss) from operations	(2,647)	3,713	(1,179)	(113)
Segment assets	47,852	29,005	10,428	87,285
Segment goodwill and intangibles, net	22,631	10,563		33,194

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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,	
	2004	2003	2004	2003
Total revenue:				
United States	$ 70,285	$ 64,056	$ 178,281	$ 147,959
Asia	35,815	1,452	65,761	2,455
North America (excluding the United States)	190		1,128	
South America	807		2,697	
Europe	2,051			