

STONEPATH GROUP INC

Form 10-Q

November 14, 2006

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**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, 2006**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 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.)

**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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

There were 43,777,151 issued and outstanding shares of the registrant's common stock, par value \$.001 per share, as of November 10, 2006.

**STONEPATH GROUP, INC.**  
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**CAUTIONARY STATEMENT FOR FORWARD-LOOKING STATEMENTS**

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, continue, or the negative of similar expressions. Although 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 achieve and sustain an annual growth rate in revenue consistent with our targets, (ii) our ability to achieve our targeted operating margins, (iii) liquidity and capital resource issues, (iv) our ability to realize the planned benefits from our restructuring efforts, (v) our dependence on certain large customers, (vi) our dependence upon certain key personnel, (vii) an unexpected adverse result in any legal proceeding, (viii) competition in the freight forwarding, logistics and supply chain management industry, (ix) the impact of current and future laws affecting the Company's operations, (x) adverse changes in general economic conditions as well as economic conditions affecting the specific industries and customers we serve, (xi) regional disruptions in transportation, and (xii) 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.

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**PART I  
FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

**STONEPATH GROUP, INC.  
Consolidated Balance Sheets  
(dollars in thousands)**

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
	<b>(UNAUDITED)</b>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 7,314	\$ 4,601
Accounts receivable, net	40,247	69,836
Prepaid expenses and other current assets	1,376	2,312
Assets held for sale	28,579	
<b>Total current assets</b>	<b>77,516</b>	<b>76,749</b>
Goodwill	13,728	43,762
Technology, furniture and equipment, net	2,833	6,856
Acquired intangibles, net	2,691	5,212
Other assets	2,150	2,703
<b>Total assets</b>	<b>\$ 98,918</b>	<b>\$ 135,282</b>
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Short-term debt	\$ 20,197	\$ 14,039
Accounts payable	30,926	50,054
Earn-outs payable	490	3,513
Accrued payroll and related expenses	2,096	3,393
Accrued restructuring costs	232	1,485
Accrued expenses	6,163	7,516
Liabilities held for sale	16,090	
<b>Total current liabilities</b>	<b>76,194</b>	<b>80,000</b>
Long-term debt	4,013	1,137
Long-term earn-outs payable		2,255
Other long-term liabilities	223	4,210
Deferred tax liability	744	2,898
<b>Total liabilities</b>	<b>81,174</b>	<b>90,500</b>

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Minority interest	4,057	6,478
Commitments and contingencies (Note 9)		
Convertible preferred stock, \$100.00 par value, 48,000 shares authorized, 30,000 shares issued	1,804	1,804
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: 43,777,151 and 43,749,693 shares at September 30, 2006 and December 31, 2005, respectively	44	44
Additional paid-in capital	223,208	222,779
Accumulated deficit	(211,716)	(186,581)
Accumulated other comprehensive income	347	258
Total stockholders' equity	11,883	36,500
Total liabilities and stockholders' equity	\$ 98,918	\$ 135,282

See accompanying notes to consolidated financial statements.

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**STONEPATH GROUP, INC.**  
**Consolidated Statements of Operations**  
**(UNAUDITED)**  
**(In thousands, except per share data)**

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Total revenue	\$ 65,251	\$ 80,973	\$ 195,684	\$ 217,432
Cost of transportation	55,337	65,502	161,641	171,928
Net revenue	9,914	15,471	34,043	45,504
Personnel costs	6,343	7,810	21,273	24,586
Other selling, general and administrative costs	4,369	6,160	15,921	20,865
Depreciation and amortization	915	1,056	2,592	3,136
Asset impairment	20,069		20,069	
Litigation settlement	(1,038)		(1,038)	
Restructuring charges			(735)	3,130
Income (loss) from operations	(20,744)	445	(24,039)	(6,213)
Other income (expense):				
Interest expense, net	(2,185)	(953)	(5,125)	(2,086)
Change in fair value of derivatives	661	(740)	3,967	(740)
Loan refinancing costs		(912)		(912)
Other income (expense), net	4	1	5	3
Loss from continuing operations before income tax expense and minority interest	(22,264)	(2,159)	(25,192)	(9,948)
Income tax benefit (expense)	1,791	(427)	1,257	(1,526)
Loss before minority interest	(20,473)	(2,586)	(23,935)	(11,474)
Minority interest	153	(297)	(118)	(902)
Loss from continuing operations	(20,320)	(2,883)	(24,053)	(12,376)
Discontinued operations:				
Income (loss) from operations, net of tax	(325)	1,881	559	3,428
Loss on disposal of business segment, net of tax	(1,371)		(1,371)	
Income (loss) from discontinued operations	(1,696)	1,881	(812)	3,428
Net loss	(22,016)	(1,002)	(24,865)	(8,948)
Preferred stock dividends	(90)		(270)	

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Net loss attributable to common stockholders	\$ (22,106)	\$ (1,002)	\$ (25,135)	\$ (8,948)
Basic and diluted loss per common share:				
Continuing operations	\$ (0.46)	\$ (0.06)	\$ (0.56)	\$ (0.29)
Discontinued operations	(0.04)	0.04	(0.02)	0.08
Loss per common share	\$ (0.50)	\$ (0.02)	\$ (0.58)	\$ (0.21)
Weighted average shares outstanding:				
Basic and diluted	43,777	43,713	43,759	43,551

See accompanying notes to consolidated financial statements.

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

	<b>Nine months ended September</b>	
	<b>30,</b>	
	<b>2006</b>	<b>2005</b>
Cash flow from operating activities:		
Net loss	\$ (25,135)	\$ (8,948)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Deferred income taxes	(1,574)	330
Depreciation and amortization	2,592	3,136
Change in fair value of derivatives	(3,967)	740
Amortization of loan discount and fees	1,615	82
Minority interest in income of subsidiaries	118	902
Interest on obligations to minority shareholders	272	
Stock-based compensation	251	31
Gain on disposal of technology, furniture and equipment and other	60	(15)
Asset impairment	20,069	
Loss on sale of subsidiaries	1,371	
Changes in assets and liabilities:		
Accounts receivable	14,386	(5,024)
Prepaid expenses and other assets	731	87
Accounts payable and accrued expenses	(14,966)	12,194
Advances from minority shareholders	(19)	
Discontinued operations, working capital and non-cash changes	1,134	(1,435)
Net cash (used in) provided by operating activities	(3,062)	2,080
Cash flows from investing activities:		
Purchases of technology, furniture and equipment	(346)	(959)
Proceeds from sales of technology, furniture and equipment	153	78
Payment of earn-out	(500)	(1,518)
Discontinued operations, investing activities	(64)	(973)
Net cash used in investing activities	(757)	(3,372)
Cash flows from financing activities:		
Proceeds from credit facilities, net	6,993	6,005
Principal payments on capital leases	(135)	(1,245)
Payment to minority shareholder	(416)	
Payment of debt issuance costs		(1,110)

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Net cash provided by financing activities	6,442	3,650
Effect of foreign currency translation	90	228
Net increase in cash and cash equivalents	2,713	2,586
Cash and cash equivalents at beginning of period	4,601	2,801
Cash and cash equivalents at end of period	\$ 7,314	\$ 5,387
Cash paid for interest	\$ 2,284	\$ 1,835
Cash paid for income taxes	\$ 504	\$ 62
Supplemental disclosure of non-cash investing and financing activities:		
Issuance of notes payable in connection with financing of earn-out payments	\$ 2,377	\$
Increase in goodwill related to accrued earn-out payments	568	2,300
Issuance of warrants in connection with loan refinancing	170	
Issuance of common stock in connection with employee stock purchase plan	8	57
Issuance of common stock in connection with acquisitions		854
Issuance of warrants in connection with loan refinancing		1,294
Recognition of loan discount on conversion option in connection with loan refinancing		3,771

See accompanying notes to consolidated financial statements.

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**STONEPATH GROUP, INC.**  
**Notes to Unaudited Consolidated Financial Statements**  
**September 30, 2006**

**(1) Nature of Operations and Basis of Presentation**

Stonepath Group, Inc., including its subsidiaries (the Company), is a non-asset-based third-party logistics services company providing supply chain solutions on a global basis. A range of time and date certain transportation and distribution solutions is offered through its Domestic Services segment, where the Company manages and arranges 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 range of international logistics services including international air and ocean transportation as well as customs house brokerage services were offered through the Company's International Services segment. In addition to these core service offerings, the Company also provides a broad range of supply chain management services, including warehousing, order fulfillment and inventory control. The Company serves a customer base of manufacturers, distributors and national retail chains through a network of owned offices in the United States, strategic locations in the Asia Pacific region, 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. Although 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, 2005. 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. The Company's first and second quarters are likely to be weaker as compared with other fiscal quarters, which the Company believes 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 view of these matters, recoverability of a significant portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon future profitable operations of the Company. Further, in addition to improving operating profitability, in order for the Company to meet its existing obligations after the sale of our U.S. and Germany international operations, we require relief from the placement of \$1.9 million of borrowing base reserves on our credit facility by our U.S. lender. If we do not obtain such relief or if we are unable to obtain alternative financing on favorable terms and if we fail to achieve operating profitability we could be required to further reduce the size of our business operations through the closure of facilities, further reduce personnel and expenses, sell additional subsidiaries or explore other strategic options. There is no assurance that we can achieve these actions to ensure continued uninterrupted business operations. The Company's consolidated financial statements do not include any adjustments that may result from the outcome of this uncertainty.

Certain amounts for prior periods have been reclassified in the consolidated financial statements to conform to the classification used in 2006.

**(2) Discontinued Operations**

On October 19, 2006, the Company completed the sale of its Stonepath Logistics International Services, Inc. (SLIS) subsidiary and its Stonepath Logistics (Germany) GmbH subsidiary to JTM Acquisition Corporation (JTM). SLIS, which was acquired by the Company in 2002, was the Company's North American based logistics business providing international air and ocean logistics services. Net proceeds of \$16,981,000 were to be realized from the transactions, and the Company will further avoid future payments of up to \$969,000 in contingent earn-out obligations associated with a previous acquisition of SLIS. The proceeds were used to reduce short-term debt outstanding under the Company's U.S. credit facility and reduce earn-out obligations due selling shareholders of these operations. The Company has estimated the loss on this transaction, net of taxes to be \$1,371,000.

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JTM was formed by and its President is Mr. Jason Totah, who served as the Company's CEO until July 20, 2006, when he temporarily resigned his position pending consummation of the sale. Upon completion of the SLIS transaction, Mr. Robert Arovas, who held the CEO position on an interim basis since July 2006, was appointed CEO.

The following is a summary of selected financial data concerning the sold operations and classified as discontinued operations in the consolidated statements of operations (in thousands):

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Total Revenue	\$ 28,861	\$ 30,339	\$ 82,495	\$ 83,896
Expenses	29,118	28,404	81,731	80,305
Income (loss) before income tax expense	(257)	1,935	\$ 764	\$ 3,591
Income tax expense	(68)	(54)	(205)	(163)
Income (loss) from discontinued operations	\$ (325)	\$ 1,881	\$ 559	\$ 3,428

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The following is a summary of assets and liabilities associated with the sold operations and classified as held for sale on the consolidated balance sheet as of September 30, 2006 (in thousands):

	<b>September 30, 2006</b>
Accounts receivable, net	\$ 15,493
Other current assets	50
Goodwill	11,816
Technology, furniture, equipment, net	638
Acquired intangibles, net	250
Other long-term assets	332
 Assets held for sale	 \$ 28,579
 Short-term debt	 \$ 1,101
Accounts payable	8,779
Earn-outs payable	3,255
Accrued payroll and related expenses	1,363
Accrued expenses and other	798
Deferred tax liability	794
 Liabilities held for sale	 \$ 16,090

**(3) Asset Impairment**

The fair value of the Company's domestic segment was tested for impairment during the three-month period ended September 30, 2006. This assessment was performed due to revenue and operating income trends which were significantly below expectations in one of the Company's business units which indicated the fair value of the domestic segment was below its carrying amount. This business unit was acquired in 2001 and was formerly known as Air Plus. The Company also assessed its other business units within its domestic segment in connection with this review.

Prior to this most recent test, the Company historically had aggregated the expected future cash flows of each of its three domestic business units, which were acquired in separate transactions between 2001 and 2003, in its required annual impairment test performed in accordance with provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*. The Company's executive management primarily reviewed and measured performance on a total domestic segment basis as it was anticipated that operating and marketing synergies would be created between the individual units. Although certain synergies have been achieved since the date of acquisition of these business units, they have largely remained separate from a customer segment and service perspective. Although the Company believes further operating synergies can be achieved between the units, it currently believes it is appropriate to measure its domestic business units individually as opposed to its historical aggregation methodology.

The Company determined the fair value of its individual domestic business units primarily by estimating the expected present value of future cash flows. In considering the provisions of SFAS No. 142 and SFAS No. 144, *Accounting for the Impairment of Disposal of Long-Lived Assets*, the Company recorded an asset impairment charge of \$18,840,000, which included adjustments to goodwill, acquired intangibles and certain computer assets. The Company further reviewed its South American operations and determined the full amount of goodwill recorded with this acquisition, which occurred in 2004, was not recoverable and recorded an impairment charge of \$1,229,000.

The allocation of the impairment charge to previously recorded assets and business segments as of September 30, 2006 is as follows (in thousands):

**Total**

	<b>Domestic Services</b>	<b>International Services</b>	
Goodwill	\$ 16,187	\$ 1,229	\$ 17,416
Technology, furniture, equipment	1,571		1,571
Acquired intangibles	1,082		1,082
<b>Total</b>	<b>\$ 18,840</b>	<b>\$ 1,229</b>	<b>\$ 20,069</b>

**(4) Restructuring Charges**

In late 2004, the Company commenced a restructuring program, designed to accelerate the integration of its businesses and improve the Company's overall profitability. This program and related initiatives were substantially completed by June 30, 2005. A summary of remaining restructuring liabilities, adjustments to liabilities, and cash payments is as follows for the nine-month period ended September 30, 2006 (in thousands):

	<b>Liability Balance January 1, 2006</b>	<b>Restructuring Charges</b>	<b>Adjustments</b>	<b>Cash Payments</b>	<b>Liability Balance September 30, 2006</b>
Personnel	\$ 159	\$	\$	\$ (159)	\$
Building leases	1,326		(735)	(359)	232
	<b>\$ 1,485</b>	<b>\$</b>	<b>\$ (735)</b>	<b>\$ (518)</b>	<b>\$ 232</b>

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Personnel charges primarily relate to contractual obligations incurred in 2005 with certain executives. Remaining lease termination costs relate to the 2005 vacating of a Domestic facility. Effective May 2006, the Company agreed to sublease its remaining vacated Domestic facility for the remainder of the term of the original lease that extends through February 2008. In connection with this sublease, which reimburses the Company for a majority of the lease payments due to the lessor, the Company recorded a restructuring credit and related reductions in liabilities of \$735,000 during the three-month period ended June 30, 2006.

**(5) Stock-Based Compensation**

At September 30, 2006, the Amended and Restated Stonepath Group, Inc. 2000 Stock Incentive Plan covered 15,000,000 shares of common stock. Under its terms, employees, officers and directors of the Company and its subsidiaries are currently eligible to receive non-qualified and incentive stock options and restricted stock awards. Options granted generally vest over three to four years and expire ten years following the date of grant. The Board of Directors or a committee thereof determines the exercise price of options granted.

Prior to January 1, 2006, the Company accounted for stock-based compensation under the recognition and measurement provisions of Accounting Principles Board ( APB ) No. 25, Accounting for Stock Issued to Employees, and related interpretations, as permitted by Statement of Financial Accounting Standards ( SFAS ) No. 123, *Accounting for Stock-Based Compensation* . No stock-based compensation was recognized in the Statement of Operations for the three and nine-months ended September 30, 2005, as all outstanding unvested options granted under the plan at that time had an exercise price equal to the market value of the underlying common stock on the date of grant. The Company accounted 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*. In addition, the Company disclosed pro forma amounts illustrating the effect on net income or loss attributable to common stockholders and income or loss per share as if the fair value of options granted had been recognized in accordance with the provisions of SFAS No. 123.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), *Share Based Payment*, using the modified-prospective-transition method. SFAS No. 123(R) supersedes APB No. 25, and amends SFAS No. 95, *Statement of Cash Flows*. Generally the fair value approach in SFAS No. 123(R) is similar to the fair value approach described in SFAS No. 123. The Company uses the Black-Scholes formula to estimate the fair value of stock options granted to employees. Based on the terms of the stock option plan, the Company did not have a cumulative effect related to the implementation of SFAS No. 123(R) and results for prior periods have not been restated. As of September 30, 2006, there was approximately \$497,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the plan. The cost is expected to be recognized over a weighted-average period of approximately 1.7 years. This expected cost does not include the impact of any future stock-based compensation awards. In connection with the sale of SLIS (Note 2), the Company agreed to extend the expiration term of options originally issued to employees of SLIS from their customary 90 days after termination to three years after the date of sale. This extension resulted in a cost of \$63,000 being recorded as of the date of the modification.

As a result of the adoption of SFAS No. 123(R), the Company's income (loss) before income tax expense and minority interest and net income (loss) attributable to common shareholders was lower by \$83,000 and \$249,000 for the three and nine-month periods ended September 30, 2006, respectively. The adoption did not lower the Company's reported loss per common share from continuing operations for the three-month period ended September 30, 2006. The adoption did lower the Company's reported loss per common share for the nine-month period ended September 30, 2006 by \$.01. The adoption of SFAS No. 123(R) had no effect on reported cash flows or stockholder's equity for the three and nine-month periods ended September 30, 2006. Although no options were exercised during any period covered by this report and accordingly did not record any related tax benefits, under SFAS No. 123(R) any tax benefits resulting from tax deductions in excess of compensation cost recognized for those options would have classified as a financing cash flow instead of an operation cash flow if the Company had not adopted SFAS No. 123(R).

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The following table shows the effect on net loss attributable to common stockholders and loss per common share if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted in periods presented prior to adoption of SFAS No. 123(R). For purposes of this pro forma disclosure, the value of the options is estimated using the Black-Scholes option-pricing model and amortized to expense over the options vesting periods.

**Three months  
ended**

**Nine months  
ended**