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STONEPATH GROUP INC
Form 10-Q/A
March 16, 2005

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 March 31, 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 41,199,102 issued and outstanding shares of the registrant's common stock, par value \$.001 per share, at May 5, 2004.

STONEPATH GROUP, INC.

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Introductory Note

On September 20, 2004, Stonepath Group, Inc. (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. 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. This Form 10-Q/A reflects restated amounts for the first quarter of 2004 and 2003, together with a description of events occurring subsequent to the filing of Form 10-Q for the first quarter of 2004 related to such restatement. Accordingly, all notes to the financial statements are as of March 31, 2004 unless otherwise indicated. In addition, Item 2 of Part I, Management's Discussion and Analysis of Financial Condition and Results of Operations, has been updated as has Item 4 of Part I, Controls and Procedures.

Part I. FINANCIAL INFORMATION

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Item 1. Financial Statements

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

	March 31, 2004	December 31, 2003
	Restated (See Note 2)	(See Note 2)
Assets		
Current assets:		
Cash and cash equivalents	\$ 4,054,784	\$ 4,054,784
Accounts receivable, net	46,872,985	46,872,985
Other current assets	3,815,323	3,815,323
	-----	-----
Total current assets	54,743,092	54,743,092
Goodwill and acquired intangibles, net	40,609,682	40,609,682
Furniture and equipment, net	8,293,749	8,293,749
Other assets	1,168,959	1,168,959
	-----	-----
	\$ 104,815,482	\$ 104,815,482
	=====	=====
Liabilities and Stockholders' Equity		
Current liabilities:		
Line of credit-bank	\$ 8,623,305	\$ 8,623,305
Accounts payable	30,480,881	30,480,881
Accrued expenses	7,326,644	7,326,644
Earn-out payable	1,157,738	1,157,738
Capital lease obligation	796,049	796,049
	-----	-----
Total current liabilities	48,384,617	48,384,617
Capital lease obligation, net of current portion	1,225,335	1,225,335
Deferred tax liability	1,156,600	1,156,600
	-----	-----
Total liabilities	50,766,552	50,766,552
	-----	-----
Minority interest	2,087,100	2,087,100
	-----	-----
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, \$.001 par value, 10,000,000 shares authorized; Series D Convertible, issued and outstanding: 192,807 and 310,480 shares at 2004 and 2003, respectively	193	193
Common stock, \$.001 par value, 100,000,000 shares authorized; issued and outstanding: 39,943,477 and 37,449,944 shares at 2004 and 2003,		

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respectively	39,943	
Additional paid-in capital	221,347,937	
Accumulated deficit	(169,463,983)	(
Accumulated other comprehensive income	37,740	
Deferred compensation	--	
	-----	---
Total stockholders' equity	51,961,830	
	-----	---
Total liabilities and stockholders' equity	\$ 104,815,482	\$
	=====	====

See accompanying notes to unaudited consolidated financial statements.

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

	Three months en

	2004

	Restated
	(See Note 2)
Total revenue	\$ 60,224,390
Cost of transportation	43,472,712

Net revenue	16,751,678
Personnel costs	9,897,742
Other selling, general and administrative costs	8,308,401
Depreciation and amortization	850,836
Litigation settlement	--

Loss from operations	(2,305,301)
Other income (expense)	
Provision for excess earn-out payments	(3,075,190)
Interest income (expense), net	(35,739)
Other income (expense), net	(15,508)

Loss before income tax expense and minority interest	(5,431,738)
Income tax expense	199,100

Loss before minority interest	(5,630,838)
Minority interest	69,608

Net loss	\$ (5,700,446)

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Basic and diluted loss per common share	\$ (0.15)
Basic and diluted weighted average common shares outstanding	38,385,489

See accompanying notes to unaudited consolidated financial statements.

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

	Three months end ----- 2004 ---- Restated (See Note 2)
Cash flow from operating activities:	
Net loss	\$ (5,700,446)
Adjustments to reconcile net loss to net cash used in operating activities:	
Deferred income taxes	121,000
Depreciation and amortization	850,836
Minority interest in income of subsidiaries	69,608
Stock-based compensation	21,174
Loss on disposal of furniture and equipment	10,450
Changes in assets and liabilities, net of effect of acquisitions:	
Accounts receivable	4,997,308
Other assets	17,686
Accounts payable and accrued expenses	(3,246,478)

Net cash used in operating activities	(2,858,862)

Cash flows from investing activities:	
Purchases of furniture and equipment	(1,081,720)
Acquisition of business, net of cash acquired	(2,334,012)
Payment of earn-out	(2,390,796)
Loans made	(75,000)

Net cash used in investing activities	(5,881,528)

Cash flows from financing activities:	
Proceeds from line of credit	8,623,305
Issuance of common stock, net of costs	--
Issuance of common stock upon exercise of options and warrants	1,237,357
Principal payments on capital lease	(175,382)

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Net cash provided by financing activities	9,685,280

Effect of foreign currency translation	35,743

Net increase in cash and cash equivalents	980,633
Cash and cash equivalents at beginning of period	3,074,151

Cash and cash equivalents at end of period	\$ 4,054,784
	=====
Cash paid for interest	\$ 45,256
	=====
Cash paid for income taxes	\$ 51,261
	=====
Supplemental disclosure of non-cash investing and financing activities:	
Increase in furniture and equipment and capital lease obligation	\$ 390,754
Increase in common stock from conversion of Series D preferred stock	\$ 117

See accompanying notes to unaudited consolidated financial statements.

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
March 31, 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 management. The Company services a customer base of 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 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/A for the year ended December 31, 2003. Interim operating

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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.

(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. Such items also impacted the first quarter of 2004. In connection with the preparation of its consolidated financial statements for the year ended December 31, 2004, the Company also identified an understatement of certain claims expenses amounting to \$251,000 which pertained to the first quarter of 2004. The accompanying consolidated financial statements as of March 31, 2004 and for the three-month period then ended have been restated to reflect the effect of these adjustments. The effects of these restatements on previously reported consolidated financial statements as of December 31, 2003 and March 31, 2004 and for the three-month periods ended March 31, 2004 and 2003 are summarized below.

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
March 31, 2004

	December 31, 2003	
	As Previously Reported	As Re
Select Balance Sheet Data:		
Accounts receivable, net	\$ 38,470,366	\$ 38,
Total current assets	43,775,834	43,
Goodwill and acquired intangibles, net	42,540,104	38,
Deferred taxes	1,695,000	
Total assets	96,438,811	90,
Accounts payable	16,119,014	22,
Accrued expenses	4,030,192	3,
Earn-out payable	6,623,724	3,
Total current liabilities	27,444,127	30,
Deferred tax liability	--	1,
Total liabilities	28,578,942	32,
Accumulated deficit	(153,572,460)	(163,
Total stockholders' equity	66,514,079	56,
Total liabilities and stockholders' equity	96,438,811	90,

March 31, 2004

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	As Previously Reported	As Re
Select Balance Sheet Data:		
Accounts receivable, net	\$ 47,402,077	\$ 46,
Other current assets	4,432,223	3,
Total current assets	55,889,084	54,
Goodwill and acquired intangibles, net	44,864,962	40,
Deferred taxes	1,574,000	
Total assets	111,790,754	104,
Accounts payable	23,506,131	30,
Total current liabilities	41,409,867	48,
Deferred tax liability	--	1,
Total liabilities	42,635,202	50,
Accumulated deficit	(154,357,361)	(169,
Total stockholders' equity	67,068,452	51,
Total liabilities and stockholders' equity	111,790,754	104,

	As Previously Reported	As Re
Select Statement of Operations Data:		
Revenue	\$60,533,707	\$ 60,
Cost of transportation	42,809,574	43,
Net revenue	17,724,133	16,
Other selling, general and administrative costs	8,057,401	8,
Loss from operations	(1,081,846)	(2,
Provision for excess earn-out payments	--	(3,
Loss before income tax expense (benefit) and minority interest	(1,133,093)	(5,
Income tax expense (benefit)	(417,800)	
Loss before minority interest	(715,293)	(5,
Net loss	(784,901)	(5,
Basic and diluted loss per common share	\$ (0.02)	\$

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	Reported -----	As Re -----
Select Statement of Cash Flows Data:		
Net loss	\$ (784,901)	\$ (5,
Accounts receivable	4,687,992	4,
Other assets	(599,214)	
Accounts payable and accrued expenses	(4,160,617)	(3,
Net cash provided by (used in) operating activities	216,328	(2,
Payment of earn-out	(5,465,986)	(2,
Net cash used in investing activities	(8,956,718)	(5,

	Three Months Ended March -----	
	As Previously Reported -----	As Re -----
Select Statement of Operations Data:		
Cost of transportation	\$26,388,801	\$ 26,
Net revenue	12,183,640	11,
Loss from operations	(21,591)	(
Provision for excess earn-out payments	--	(1,
Income (loss) before income tax expense and minority interest	7,916	(1,
Income tax expense	15,221	
Loss before minority interest	(7,305)	(1,
Net loss	(7,305)	(1,
Basic and diluted loss per common share	\$ --	\$

	Three Months Ended March -----	
	As Previously Reported -----	As Re -----
Select Statement of Cash Flows Data:		
Net loss	\$ (7,305)	\$ (1,
Accounts payable and accrued expenses	(3,697,654)	(3,
Net cash used in operating activities	(670,660)	(1,
Payment of earn-out	(2,819,150)	(1,
Net cash used in investing activities	(4,623,368)	(3,

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
March 31, 2004

(3) Stock-Based Compensation

In December 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," which amended the disclosure

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requirements of SFAS No. 123, "Accounting and Disclosure of Stock-Based Compensation" to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company accounts for its employee stock option grants by applying the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations.

The table below illustrates the effect on net loss attributable to common stockholders and 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 March 31,	
	Restated 2004	Restated 2003
Net loss:		
As reported	\$ (5,700,446)	\$ (1,656,934)
Add: stock-based employee compensation expense included in reported net loss	21,174	23,808
Deduct: total stock-based compensation expense determined under fair value method for all awards	(2,154,238)	(941,387)
	\$ (7,833,510)	\$ (2,574,513)
	=====	=====
Pro forma net loss		
Basic and diluted loss per common share:		
As reported	\$ (0.15)	\$ (0.07)
Pro forma	(0.20)	(0.10)

(4) 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 and \$2,000,000 of the Company's common stock. The seller may receive additional consideration of up to an additional \$5,500,000 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 Company used funds from its credit facility with LaSalle Business Credit, Inc. for the cash payment at the closing. 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 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.

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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 will be 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 will not be reflected in the consolidated financial statements until the second quarter of 2004. The total purchase price, including acquisition expenses of \$266,000, but excluding the contingent consideration, was \$3,766,000. The following table summarizes the preliminary allocation of the purchase price based on estimated fair value of the assets acquired and liabilities assumed at March 1, 2004 (in thousands):

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
March 31, 2004

Current assets	\$	16,691
Furniture and equipment		89
Goodwill and other intangible assets		2,701

Total assets acquired		19,481
Current liabilities assumed		(14,844)
Minority interest		(871)

Net assets acquired	\$	3,766
		=====

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:

	March 31, 2004	March 31, 2003
	-----	-----
	Restated	Restated
Revenue	\$ 80,221	\$ 51,806
Net loss	(5,136)	(1,907)
Loss per share:		
Basic and diluted	\$ (0.13)	\$ (0.08)

(5) Revolving Credit Facility

To ensure adequate financial flexibility, the Company has a \$20,000,000 revolving credit facility (the "Facility") collateralized by the accounts receivable and the other assets of the Company and its subsidiaries. The Facility requires the Company and its subsidiaries to meet certain financial objectives and maintain certain financial covenants. Advances under the Facility may be used to finance future acquisitions, capital expenditures or for other corporate purposes. We expect that the cash flow from operations of our subsidiaries will be sufficient to support the corporate overhead of the Company and some portion, if not all, of the contingent earn-out payments and other cash requirements associated with our acquisitions. Therefore, we anticipate that our primary use of the Facility will be to finance the cost of new acquisitions and to pay any portion of existing earn-out arrangements that cash flow from operations is otherwise unable to fund. At March 31, 2004 we had advances of \$1,200,000 and approximately \$7,400,000 in outstanding checks which have been classified as incremental borrowings. Based upon available collateral and net of \$1,200,000 in advances under the Facility, outstanding letter of credit

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commitments and funds reserved for off-shore investments, there was approximately \$12,200,000 available for borrowing under our Facility. In July 2004, the maximum availability under the Facility was increased to \$25,000,000.

On July 28, 2004, the Company amended its Facility to provide a bridge loan with a principal amount of \$5,000,000, a term of 120 days and 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. The Company borrowed the full \$5,000,000 available for the bridge loan on August 24, 2004 and subsequently repaid the bridge loan facility on November 26, 2004.

As discussed in Note 2, the Company has restated its consolidated financial statements. These restated amounts resulted in the 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.

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
March 31, 2004

(6) Commitments and Contingencies

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 March 31, 2003 unaudited consolidated statement of operations.

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 statements made during that period. The Company and the individual defendants

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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 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.

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Stonepath Group, Inc.
Notes to Unaudited Consolidated Financial Statements
March 31, 2004

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 in November 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 \$5,100,000 and received the right to receive an additional \$11,000,000 in four annual installments based upon UAF's performance in accordance with the Stock Purchase Agreement. Subject to the purchase, Stonepath Logistics Domestic

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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.

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Stonepath Group, Inc. Notes to Unaudited Consolidated Financial Statements March 31, 2004

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 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 them 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 192,807 shares of Series D Preferred Stock outstanding as of March 31, 2004.

Each share of the Series D Convertible Preferred Stock is convertible into ten shares of common stock of the Company. Subsequent to December 31, 2003, 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

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31, 2004.

During the three months ended March 31, 2004, 117,000 shares of the Company's Series D Preferred Stock were converted into 1,170,000 shares of the Company's common stock.

Stock Options

During the three months ended March 31, 2004, options on 2,045,200 shares were granted. The range of exercises prices on granted options was \$2.38 to \$3.75 per share and the weighted average exercise price was \$3.02 per share.

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Options on 45,417 shares expired during the three months ended March 31, 2004. The range of exercise prices was \$1.30 to \$2.30 per share and the weighted average exercise price was \$1.66 per share.

During the three months ended March 31, 2004, options on 873,000 shares were exercised. The range of exercise prices was \$0.60 to \$1.38 per share and the weighted average exercise price was \$0.97 per share.

During the three months ended March 31, 2004, non-employees exercised warrants for the purchase of 443,833 shares of the Company's common stock. The exercise price of all exercised warrants was \$1.00 per share.

(8) Loss per Share

Basic loss per common share and diluted loss per common share are presented in accordance with SFAS No. 128, "Earnings per Share." Basic loss per common share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted 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. For the three months ended March 31, 2004 and 2003, all stock options, stock warrants, and convertible securities were excluded because their effect was antidilutive. The total numbers of such shares excluded from diluted loss per common share are 10,821,405 and 8,666,447 at March 31, 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 loss per common share for the three months ended March 31, 2004.

(9) Income Taxes

The components of income tax expense consist of the following:

	Three Months Ended March 31,	
	Restated 2004	Restated 2003
U.S. federal	\$ 105,100	\$ 112,200
State	26,900	29,000
Foreign	67,100	7,821
	\$ 199,100	\$ 149,021

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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 (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-month periods ended March 31, 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.

(10) 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/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):

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	Three months ended March 31, 2004		
	Restated Domestic Services	International Services	Corporate
Revenue from external customers	\$ 34,695	\$ 25,529	\$ --
Intersegment revenue	8	12	--
Revenue from significant customer	11,761	--	--
Segment operating income (loss)	(2,563)	258	--
Segment assets	42,948	57,059	4,808
Segment goodwill	19,551	12,366	--
Depreciation and amortization	658	193	--
Capital additions	414	127	931
	Three months ended March 31, 2003		
	Restated Domestic Services	International Services	Corporate
Revenue from external customers	\$ 23,774	\$ 14,798	\$ --
Intersegment revenue	34	28	--
Revenue from significant customer	9,835	--	--
Segment operating income (loss)	17	466	(750)

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Segment assets	37,269	14,056	1,809
Segment goodwill	14,039	5,002	--
Depreciation and amortization	521	69	--
Capital additions	344	37	1,353

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

	Three months ended March 31,	
	Restated 2004	2003
Total revenue:		
United States	\$52,936	\$38,123
Asia	6,071	449
North America (excluding the United States)	124	--
Europe	668	--
Other	425	--
Total	\$60,224	\$38,572

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

	March 31,	
	2004	2003
United States	\$7,893	\$4,731
Asia	401	17
Total long-lived assets	\$8,294	\$4,748

(11) Subsequent Events

Effective November 17, 2004, we amended our revolving credit facility (the "Amended Facility") with LaSalle Business Credit, LLC in connection with securing waivers to the technical default resulting from our restated financial results. See Note 5 for a summary of changes in the Amended Facility.

Effective October 27, 2004, Stonepath Holdings (Hong Kong) Limited ("Asia Holdings") entered into a \$10,000,000 term credit facility with Hong Kong League Central Credit Union (the "Asia Facility") collateralized by the accounts receivable of the Company's Hong Kong and Singapore operations and an unsecured guarantee from Stonepath Group, Inc. The Asia Facility carries a term of one year and an interest rate of 15% for amounts outstanding thereunder. On November 4, 2004, Asia Holdings borrowed \$3,000,000 under the Asia Facility.

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On November 5, 2004, Asia Holdings distributed \$1,045,000 in satisfaction of amounts due in connection with the working capital acquired in the Shaanxi transaction and repaid \$1,500,000 of intercompany loans to Stonepath Group, Inc. which was applied to the \$5,000,000 bridge loan facility.

On December 8, 2004, the Company received acceptance of its plan to regain compliance with the American Stock Exchange ("Amex") continued listing standards so long as such compliance was achieved by January 6, 2005. Amex has continued the Company's listing pursuant to the extension. Amex had previously notified the Company that it was not in compliance with the requirements of Section 134 and 1101 of the Amex Company Guide as a result of its failure to timely file its Form 10-Q for the period ended September 30, 2004. After consulting with its outside auditors and counsel, the Company chose not to file Form 10-Q when due until the Company had finalized its restatement process. This approach was abandoned when it became evident that KPMG LLP could not complete its audit within the time stipulated in the accepted plan to regain compliance. On January 6, 2005, the Company notified the Amex that completion of the audit by KPMG LLP had been delayed, but that it expected KPMG LLP to finalize its audit within the next few weeks. On January 28, 2005, the Company received notice from Amex that it had accepted the Company's updated plan of compliance dated January 6, 2005 and that it would continue the Company's listing pursuant to an extension until February 28, 2005. KPMG has completed its audit, and the Company filed its Form 10-K/A for the year ended December 31, 2003 on February 11, 2005. On February 25, 2005, the Company filed its Form 10-Q/A for the period ended September 30, 2004. On February 28, 2005, Amex notified the Company that it had regained compliance with the continued listing standards of Amex.

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

Cautionary Statement For Forward-Looking Statements

This Quarterly Report on Form 10-Q/A 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 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 identify, acquire, integrate and manage additional businesses in a manner which does not dilute our earnings per share, (iv) our ability to obtain the capital necessary to make additional acquisitions, (v) the uncertainty of future trading prices of our common stock

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and the impact such trading prices may have upon our ability to utilize our common stock to facilitate our capital raising efforts and associated acquisition strategy, (vi) the uncertain effect on the future trading price of our common stock associated with the possible additional issuance of securities upon the conversion or exercise of outstanding convertible securities and to satisfy existing contractual commitments, (vii) our dependence on certain large customers, (viii) our dependence upon certain key personnel, (ix) an unexpected adverse result in any legal proceeding, (x) the scarcity and competition for the operating companies we need to acquire to implement our business strategy, (xi) competition in the freight forwarding, logistics and supply chain management industry, (xii) the impact of current and future laws affecting the Company's operations, (xiii) adverse changes in general economic conditions as well as economic conditions affecting the specific industries and customers we serve, (xiv) regional disruptions in transportation, (xv) the risk that the actual results of recently acquired businesses are not consistent with their historical results and forward-looking guidance provided to us at the time of acquisition, (xvi) the effect that the restatement of our consolidated financial statements will have on the trading price of our common stock, (xvii) our ability to replace our credit facility which restricts our ability to make any further acquisitions and (xviii) 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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OVERVIEW

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 the Domestic Services platform, where we manage and arrange the movement of raw materials, supplies, components and finished goods for our customers. We offer a full range of international logistics services, including international air and ocean transportation as well as customs house brokerage services, through the International Services platform. In addition to these core service offerings, we also provide a broad range of value added supply chain management services, including warehousing, order fulfillment and inventory control solutions. We service a diverse customer base including manufacturers, distributors and national retail chains through a network of offices in 24 major metropolitan areas in North America, Puerto Rico, ten locations in Asia and five locations in South America, using an extensive network of independent carriers and service partners strategically located around the world.

As a non-asset based provider of third-party logistics services, we seek to limit our investment in equipment, facilities and working capital through contracts and preferred provider arrangements with various transportation providers who generally provide us with favorable rates, minimum service levels, capacity assurances and priority handling status. The volume of our flow of freight enables us to negotiate attractive pricing with our transportation providers.

Our strategic objective is to build a leading global logistics services organization that integrates established operating businesses and innovative technologies. We plan to achieve this objective by broadening our network through a combination of synergistic acquisitions and the organic expansion of

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our existing base of operations. The focus of this strategy is on acquiring businesses that have demonstrated historic levels of profitability, have a proven record of delivering high quality services, have a customer base of large and mid-sized companies and which otherwise may benefit from our long term growth strategy and status as a public company. However, we have suspended our acquisition strategy for the near term as a result of restrictions in our amended credit facility, which prohibits further acquisitions.

Our strategy has been 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 as it remains highly fragmented, and as customers are demanding the types of sophisticated and broad-reaching service offerings that can more effectively be handled by larger, more diverse organizations. As a non-asset based provider of third-party logistics services, we can focus on optimizing the transportation solution for our customers, rather than on our own asset utilization. Our non-asset based approach allows us to maintain a high level of operating flexibility and leverage a cost structure that is highly variable in nature.

Our acquisition strategy relies upon two primary factors: first, our ability to identify and acquire target businesses that fit within our general acquisition criteria and, second, the continued availability of capital and financing resources sufficient to complete these acquisitions. Our growth strategy relies upon a number of factors, including our ability to efficiently integrate the businesses of the companies we acquire, generate the anticipated economies of scale from the integration, and maintain the historic sales growth of the acquired businesses so as to generate continued organic growth. There are a variety of risks associated with our ability to achieve our strategic objectives, including our present inability to make further acquisitions under the terms of our amended credit facility, our current reliance on a small number of key customers, the risks inherent in international operations, and the intense competition in our industry for customers. The business risks associated with these factors are identified or referred to above under our "Cautionary Statement for Forward-Looking Statements."

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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

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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 giving effect to 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 significant portion 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 on the shipment of goods into and out of the United States 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.

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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, or more specifically, our calendar year results will include results from offshore operations for the period December 1 through November 30. As a result of the one-month lag, the earnings impact of the Shaanxi transaction was first reflected in our consolidated results 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. Although these charges may increase when, and if, the Company completes more acquisitions, we believe we are actually growing the

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value of our intangible assets (e.g., customer relationships). Thus, we believe that earnings before interest, taxes, depreciation and amortization, or EBITDA, is a useful financial measure for investors because it eliminates the effect of these non-cash costs and provides an important metric for our business. Accordingly, we employ EBITDA as a measure of our historical financial performance.

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

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/A for the year ended December 31, 2003 we have discussed those policies that we believe are critical and require the use of complex judgment in their application. Since December 31, 2003, there have been no material changes to our critical accounting policies. In response to the purchased transportation issue that resulted in the Company having to restate its financial results, in the third quarter of 2004 the Company implemented a new process for purposes of accruing for estimated purchased transportation costs for its Domestic Services segment. We believe these changes will more accurately state the cost of purchased transportation and any related unpaid amounts.

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RESULTS OF OPERATIONS

Quarter ended March 31, 2004 compared to quarter ended March 31, 2003

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

	Quarter ended March 31,		Change	
	2004	2003	Amount	Percent
Total revenue	\$ 60,224 =====	\$ 38,572 =====	\$ 21,652	56.1%
Transportation revenue	\$ 55,045	\$ 35,780	\$ 19,265	53.8

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Cost of transportation	43,472	26,634	16,838	63.2
	-----	-----	-----	
Net transportation revenue	11,573	9,146	2,427	26.5
Net transportation margin	21.0%	25.6%		
Customs brokerage	2,679	1,864	815	43.7
Warehousing and other value added services	2,500	928	1,572	169.4
	-----	-----	-----	
Total net revenue	\$ 16,752	\$ 11,938	\$ 4,814	40.3%
	=====	=====	=====	
Net revenue margin	27.8%	30.9%		
	=====	=====		

Total revenue was \$60.2 million in the first quarter of 2004, an increase of 56.1% over total revenue of \$38.6 million in the first quarter of 2003. \$13.3 million or 61.5% of the increase in total revenue was attributable to organic growth with \$8.3 million or 38.5% of the increase in total revenue attributable to acquisitions. The Domestic Services platform delivered \$34.7 million in total revenue for the first quarter of 2004, an improvement of \$10.9 million and 45.9% over the same prior year period with \$8.4 million of the increase coming from same store growth and the remaining \$2.5 million in revenue growth coming from acquisitions. The International Services platform delivered \$25.5 million in total revenue for the first quarter of 2004, a year over year improvement of \$10.7 million or 72.3%, with \$4.9 million of the increase coming from same store growth and the remaining \$5.8 million improvement attributed to acquisitions.

Net transportation revenue was \$11.6 million in the first quarter of 2004, an increase of 26.5% over net transportation revenue of \$9.1 million in the first quarter of 2003. \$0.8 million, or 34.2% of the increase in net transportation revenue, was attributable to same store growth with \$1.6 million, or 65.8% of the increase, attributable to acquisitions. The Domestic Services platform delivered \$8.4 million in net transportation revenue for the first quarter of 2004, an improvement of \$1.2 million or 16.7% over the same prior year period, with \$0.6 million of the increase coming from same store growth and the remaining \$0.6 million in growth coming from acquisitions. The International Services platform delivered \$3.2 million in net transportation revenue for the first quarter of 2004, a year over year improvement of \$1.2 million or 60.0%, with \$0.2 million of the increase coming from same store growth and the remaining \$1.0 million improvement attributed to acquisitions.

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Net transportation margins decreased to 21.0% for the first quarter of 2004 from 25.6% for the first quarter of 2003. For the first quarter of 2004, net transportation margins for the Domestic Services platform declined to 25.7% from 31.1% tied primarily to one piece of low-margin business that the Company expects to discontinue by the end of the second quarter of 2004. For the International Services platform, net transportation margins declined to 14.2% from 15.5% driven primarily by general rate increases taken by the underlying asset-based carriers that we have not been able to pass along to our customers.

Net revenue was \$16.8 million in the first quarter of 2004, an increase of 40.3% over net revenue of \$11.9 million in the first quarter of 2003. \$2.9 million, or 60.8% of the increase in net revenue, was attributable to same store growth, with \$1.9 million, or 39.2% of the increase, attributable to acquisitions. The Domestic Services platform delivered \$10.6 million in net revenue for the first quarter of 2004, an improvement of \$2.6 million or 33.2%

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over the same prior year period with \$1.8 million of the increase coming from same store growth with the remaining \$0.8 million in growth coming from acquisitions. The International Services platform delivered \$6.2 million in net revenue for the first quarter of 2004, a year over year improvement of \$2.2 million or 55.0%, with \$1.0 million of the increase coming from same store growth and the remaining \$1.2 million improvement attributed to acquisitions.

Net revenue margins decreased to 27.8% for the first quarter of 2004 compared to 30.9% for the same prior year period. Net revenue margins at Domestic Services declined to 30.4% from 33.3% driven primary from the low margin business that will be winding down by the end of the second quarter of 2004. For the International Services platform, net transportation margins declined to 24.4% from 27.2% driven primarily by general rate increases taken by the underlying asset-based carriers that we have not been able to pass along to our customers.

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

	Quarter ended March 31,			
	2004		2003	
	Amount	Percent	Amount	Percent
Net revenue	\$16,752	100.0%	\$11,938	100.0%
Personnel costs	9,898	59.1	6,563	55.0
Other selling, general and administrative	8,308	49.6	4,303	36.0
Depreciation and amortization	851	5.1	590	4.9
Litigation settlement	--	--	750	6.3
Total operating costs	19,057	113.8	12,206	102.2
Loss from operations	(2,305)	(13.8)	(268)	(2.2)
Provision for excess earn-out payments	(3,075)	(18.4)	(1,270)	(10.6)
Other income (expense), net	(52)	(0.2)	30	0.2
Loss before income tax expense and minority interest	(5,432)	(32.4)	(1,508)	(12.6)
Income tax expense	199	1.2	149	1.3
Loss before minority interest	(5,631)	(33.6)	(1,657)	(13.9)
Minority interest	69	0.4	--	--
Net loss	\$ (5,700)	(34.0)%	\$ (1,657)	(13.9)

Personnel costs were \$9.9 million for the first quarter of 2004, an increase of 50.8% over \$6.6 million for the first quarter of 2003. \$0.8 million or 24.2% of the increase in personnel costs is attributable to incremental costs assumed as part of our acquisition program with \$2.5 million or 75.8% of the increase attributable to increased costs in the base business. Personnel costs as a percentage of net revenue increased to 59.1% in the first quarter of 2004 from 55.0% in the first quarter of 2003. This increase was driven by hiring of operations, sales and management personnel, particularly in our International

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Services platform. Compared to March 31, 2003, headcount increased by 570 to a total of 1,098 with 414 added in operations, 45 added in sales and marketing and 111 added in financial and administrative services.

Other selling, general and administrative costs were \$8.3 million for the first quarter of 2004, an increase of 93.1% over \$4.3 million for the first quarter of 2003. \$0.6 million or 14.6% of the increase is attributable to incremental costs assumed as part of our acquisition program with \$3.4 million or 85.4% of the increase attributable to increased costs of the base business. As a percentage of net revenue, other selling, general and administrative costs increased to 49.6% in the first quarter of 2004 from 36.0% in the first quarter of 2003. This increase is primarily due to spending related to facilities, equipment and technology particularly in our Domestic Services platform.

Depreciation and amortization was \$0.9 million in the first quarter of 2004, an increase of 44.2% over \$0.6 million in the first quarter of 2003. This increase is primarily due to the amortization of intangible assets acquired in transactions that closed after the first quarter of 2003. Depreciation and amortization as a percentage of net revenue increased to 5.1% in the first quarter of 2004 from 4.9% in the first quarter of 2003. This increase is primarily due to the amortization of acquired intangible assets.

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In the first quarter of 2003, litigation settlement charges resulted from the settlement of litigation that arose prior to our transition to a logistics business. Such settlement was ultimately paid using \$400,000 in cash and \$350,000 in shares of the Company's common stock.

Loss from operations was \$2.3 million in the first quarter of 2004, as compared to \$0.3 million for the first quarter of 2003. Loss from operations as a percentage of net revenue was (13.8)% for the first quarter of 2004 compared to (2.2)% for the first quarter of 2003.

Provision for excess earn-out payments represents 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 fact in excess of the amount that would have been paid out based upon the restated financial results for 2003. Due to differing interpretations by the Company and the selling shareholders of the earn-out provisions of the purchase agreements, the Company has determined that the resulting receivable from the former shareholders should be fully reserved for. If in the future, excess amounts paid are recovered, those proceeds would be reflected as other income on the Company's statement of operations.

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 federal net operating losses (NOLs). A portion of tax expense during the three months ended March 31, 2004 resulted from increased earnings from overseas operations. The foreign income tax provision amounted to 33.7% of the consolidated income tax provisions and the balance is due to state income taxes and deferred income taxes resulting from the amortization of goodwill for income tax purposes. At December 31, 2003, the Company had a net operating loss for federal income taxes of approximately \$24.9 million.

Net loss attributable to common stockholders was \$5.7 million in the first quarter of 2004, compared to a net loss of \$1.7 million in the first quarter of 2003. Basic and diluted loss per common share was \$0.15 for the first quarter of 2004 compared to a net loss of \$0.07 per basic and diluted common share for the first quarter of 2003.

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FINANCIAL OUTLOOK

Based upon our operating results through the first nine months of 2004, we believe that gross revenues will be approximately \$340 million in 2004 and \$375 million in 2005. Due to a number of factors, including the restated financial performance of our Domestic Services operations, the Company's intent to restructure its operations to realize synergies as part of the Company's overall acquisition strategy and future efforts to realize efficiencies from a newly developed operating system, we are not able to provide guidance at this time about expected future performance beyond gross revenues.

The restructuring initiative will include the rationalization of facilities, systems and personnel within the U.S. Some of these initiatives have been undertaken but much remains to be defined and implemented. This initiative will result in a material charge which will negatively impact the Company's financial results in the fourth quarter of 2004 and the first quarter of 2005. We will provide guidance in the future, but only after our plan is fully implemented and the newly streamlined operations have been functioning for a reasonable period of time. This moratorium on financial performance guidance will be in effect for 2005 and perhaps beyond. All previously issued financial guidance did not reflect the impact of the restatement or restructuring discussed above, nor was management aware of the issues giving rise to the restatement at the time that the previously issued guidance was provided. For these reasons, previously issued guidance relative to operating results for 2004 and 2005 is hereby withdrawn.

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SOURCES OF GROWTH

Management believes that a comparison of "same store" growth is critical in the evaluation of the quality and extent of the Company's internally generated growth. This "same store" analysis isolates the financial contributions from operations that have been included in the Company's operating results for the full comparable prior year period. The table below presents "same store" comparisons for the three-month period ended March 31, 2004 (which is the measure of any increase from the same period of 2003).

	For the three months ended March 31, 2004
Domestic	36.7%
International	33.6%

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents totaled \$4.1 million and \$3.1 million as of March 31, 2004 and December 31, 2003, respectively. Working capital totaled \$6.4 million and \$13.1 million at March 31, 2004 and December 31, 2003, respectively.

Cash used in operating activities was \$2.9 million for the first quarter of 2004 compared to \$1.9 million used in the first quarter of 2003. The change was driven principally by our net loss and the seasonal increase in our collection of receivables.

Net cash used in investing activities during the first quarter of 2004 was \$5.9 million compared to \$3.4 million in the first quarter of 2003. Investing activities were driven principally by approximately \$2.4 million in earn-out payments made in relation to 2003 performance targets, \$2.3 million

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paid for acquisitions (net of cash acquired) and \$0.7 million spent in connection with the roll-out of Tech-Logis(TM), the Company's new web-based technology platform.

Net cash provided by financing activities during the first quarter of 2004 was \$9.7 million compared to \$5.7 million in the first quarter of 2003. Financing activities consisted of \$8.6 million in proceeds from the Company's line of credit and \$1.2 million from the issuance of common stock upon the exercises of options and warrants, offset by principal payments of \$0.2 million for a capital lease. We may receive proceeds in the future from the exercise of options and warrants that were outstanding as of the end of the first quarter. As of March 31, 2004, approximately 13,170,000 options and warrants were outstanding.

	Number of shares	Proceeds if exercised
Options outstanding under our Stock Option Plan	10,684,217	\$ 17,181,613
Non-Plan Options	1,046,700	2,494,250
Warrants	1,439,563	1,499,573
	-----	-----
 Total	 13,170,480	 \$ 21,175,436
	=====	=====

Effective November 17, 2004, we amended our revolving credit facility with LaSalle Business Credit, LLC (the "U.S. Facility"). The U.S. Facility is collateralized by accounts receivable and other assets of the Company and its subsidiaries. The U.S. Facility requires the Company and its U.S. subsidiaries to comply with certain financial covenants. Advances under the U. S. Facility are available to fund future working capital and other corporate purposes. As of January 31, 2005, we had advances of \$13.9 million and we had eligible accounts receivable sufficient to support \$17.4 million in borrowings from our U.S. Facility. This U.S. Facility also included a \$5.0 million bridge loan facility available to the Company at the rate of prime plus 2.00%. The Company borrowed the full \$5.0 million available for the bridge loan facility on August 24, 2004 and subsequently repaid the bridge loan facility by November 26, 2004.

Under the terms of our amended U.S. Facility, we are not permitted to make additional acquisitions without the lender's consent. In addition, as a condition to the distribution of any earn-out payments for any of its U.S.-based operations, the amended U.S. Facility requires that the Company maintain a 60 day average undrawn availability of at least \$2.5 million after taking effect for any such earn-out distribution.

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Effective October 27, 2004, Stonepath Holdings (Hong Kong) Limited ("Asia Holdings") entered into a \$10.0 million term credit facility with Hong Kong League Central Credit Union (the "Asia Facility") collateralized by the accounts receivable of the Company's Hong Kong and Singapore operations and an unsecured subordinated guarantee from Stonepath Group, Inc. The Asia Facility carries a term of one year and an interest rate of 15% for amounts outstanding thereunder. On November 4, 2004, Asia Holdings borrowed \$3.0 million under the Asia Facility.

Below are descriptions of material acquisitions made since 2001 including a breakdown of consideration paid at closing and future potential

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earn-out payments. We define "material acquisitions" as those with aggregate potential consideration of \$5.0 million or more.

On October 5, 2001, we acquired Air Plus, a group of Minneapolis-based privately held companies that provide a full range of logistics and transportation services. The transaction was valued at up to \$34.5 million, consisting of cash of \$17.5 million paid at closing and a four-year earn-out arrangement of up to \$17.0 million. In the earn-out, we agreed to pay the former Air Plus shareholders installments of \$3.0 million in 2003, \$5.0 million in 2004, \$5.0 million in 2005 and \$4.0 million in 2006, with each installment payable in full if Air Plus achieves pre-tax income of \$6.0 million in each of the years preceding the year of payment. In the event there is a shortfall in pre-tax income, the earn-out payment will be reduced on a dollar-for-dollar basis to the extent of the shortfall. Shortfalls may be carried over or carried back to the extent that pre-tax income in any other payout year exceeds the \$6.0 million level. Based upon increased costs of purchased transportation as a result of the restatement and the Company's interpretation of the underlying purchase agreement language, the cumulative adjusted earnings for Air Plus from date of acquisition through December 31, 2003 is \$8.1 million compared to the previously calculated amount of \$12.7 million. As a result, the Company believes that it has paid approximately \$3.9 million to selling shareholders in excess of amounts that should have been paid. As a consequence of these restatements, the amounts paid in 2003 and 2004 in excess of earn-out payments due have been reclassified from goodwill to advances due from shareholders. The excess earn-out amounts applicable to 2003 earnings were previously recorded as earn-out payable at December 31, 2003. Such excess applicable to 2003 has been eliminated with a corresponding reduction in goodwill. At March 31, 2004 the excess earn-out payments related to the 2002 and 2003 results of operations have been fully reserved for because of differing interpretations, by the Company and selling shareholders, of the earn-out provisions of the purchase agreement. However, the Company will seek the refund of such excess payments.

On April 4, 2002, we acquired Stonepath Logistics International Services, Inc. ("SLIS") (f/k/a Global Transportation Services, Inc.), a Seattle-based privately held company that provides a full range of international air and ocean logistics services. The transaction was valued at up to \$12.0 million, consisting of cash of \$5.0 million paid at the closing and up to an additional \$7.0 million payable over a five year earn-out period based upon the future financial performance of SLIS. We agreed to pay the former Global shareholders a total of \$5.0 million in base earn-out payments payable in installments of \$0.8 million in 2003, \$1.0 million in 2004 through 2007 and \$0.2 million in 2008, with each installment payable in full if SLIS achieves pre-tax income of \$2.0 million in each of the years preceding the year of payment (or the pro rata portion thereof in 2002 and 2007). In the event there is a shortfall in pre-tax income, the earn-out payment will be reduced on a pro-rata basis. Shortfalls may be carried over or carried back to the extent that pre-tax income in any other payout year exceeds the \$2.0 million level. We also provided the former Global shareholders with an additional incentive to generate earnings in excess of the base \$2.0 million annual earnings target ("SLIS' tier-two earn-out"). Under SLIS' tier-two earn-out, the former Global shareholders are also entitled to receive 40% of the cumulative pre-tax earnings in excess of \$10.0 million generated during the five-year earn-out period subject to a maximum additional earn-out opportunity of \$2.0 million. SLIS would need to generate cumulative earnings of \$15.0 million over the five-year earn-out period to receive the full \$7.0 million in contingent earn-out payments. Based upon 2003 performance, the former Global shareholders received \$1.0 million on April 1, 2004. On a cumulative basis, SLIS has generated \$9.3 million in adjusted earnings, providing its former shareholders with a total of \$1.8 million in cash earn-out payments and excess earnings of \$5.8 million to carryforward and apply to future earnings targets.

On May 30, 2002, we acquired United American, a Detroit-based privately held provider of expedited transportation services. The United American transaction provided us with a new time-definite service offering focused on the automotive industry. The transaction was valued at up to \$16.1 million, consisting of cash of \$5.1 million paid at closing and a four-year earn-out arrangement based upon the future financial performance of United American. We agreed to pay the former United American shareholder a total of \$5.0 million in base earn-out payments payable in installments of \$1.25 million in 2003 through 2006, with each installment payable in full if United American achieves pre-tax income of \$2.2 million in each of the years preceding the year of payment. In the event there is a shortfall in pre-tax income, the earn-out payment will be reduced on a dollar-for-dollar basis to the extent of the shortfall. Shortfalls may be carried over or carried back to the extent that pre-tax income in any other payout year exceeds the \$2.2 million level. The Company has also provided the former United American shareholder with an additional incentive to generate earnings in excess of the base \$2.2 million annual earnings target ("United American's tier-two earn-out"). Under United American's tier-two earn-out, the former United American shareholder is entitled to receive 50% of the cumulative pre-tax earnings generated by a certain pre-acquisition customer in excess of \$8.8 million during the four-year earn-out period subject to a maximum additional earn-out opportunity of \$6.0 million. United American would need to generate cumulative earnings of \$20.8 million over the four-year earn-out period to receive the full \$11.0 million in contingent earn-out payments. Based upon increased costs of purchased transportation as a result of the restatements and the Company's interpretation of the underlying purchase agreement language, the cumulative adjusted earnings for United American from the date of acquisition through December 31, 2003 is \$1.5 million compared to the previously calculated amount of \$2.4 million. The Company believes that it has paid approximately \$0.5 million to the selling shareholder in excess of amounts due. As a consequence of these restatements, the amounts paid in 2003 in excess of earn-out payments due have been reclassified from goodwill to advances due from shareholders. The excess earn-out amounts applicable to 2003 earnings were previously recorded as earn-out payable at December 31, 2003. Such excess applicable to 2003 has been eliminated with a corresponding reduction in goodwill. At December 31, 2003, the excess earn-out payments related to the 2002 results of operations have been fully reserved for because of differing interpretations by the Company and the selling shareholders of the earn-out provisions of the purchase agreement. However, the Company will seek the refund of such excess payments.

On June 20, 2003, through our indirect wholly owned subsidiary, Stonepath Logistics Government Services, we acquired the business of Regroup, a Virginia limited liability company. The Regroup transaction enhanced our presence in the Washington, D.C. market and provided a platform to focus on the logistics needs of U.S. government agencies and contractors. The transaction was valued at up to \$27.2 million, consisting of cash of \$3.7 million and \$1.0 million of Company stock paid at closing, and a five-year earn-out arrangement. The Company agreed to pay the members of Regroup a total of \$10.0 million in base earn-out payments payable in equal installments of \$2.5 million in 2005 through 2008, if Regroup achieves pre-tax income of \$3.5 million in each of the years preceding the year of payment. In the event there is a shortfall in pre-tax income, the earn-out payment will be reduced on a dollar-for-dollar basis. Shortfalls may be carried over or carried back to the extent that pre-tax income in any other payout year exceeds the \$3.5 million level. The Company also agreed to pay the former members of Regroup an additional \$2.5 million if Regroup earned \$3.5 million in pre-tax income during the 12-month period commencing July 1, 2003, however no payment was required based on Regroup's actual results. In addition, the Company has also provided the former members of Regroup with an additional incentive to generate earnings in excess of the base \$3.5 million annual earnings target ("Regroup's tier-two earn-out"). Under

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Regroup's tier-two earn-out, the former members of Regroup are also entitled to receive 50% of the cumulative pre-tax earnings in excess of \$17.5 million generated during the five-year earn-out period subject to a maximum additional earn-out opportunity of \$10.0 million. Regroup would need to generate cumulative earnings of \$37.5 million over the five-year earn-out period in order for the former members to receive the full \$22.5 million in contingent earn-out payments.

On August 8, 2003, through two indirect international subsidiaries, we acquired a seventy (70%) percent interest in the assets and operations of the Singapore and Cambodia based operations of the G-Link Group, which provide a full range of international logistics services, including international air and ocean transportation, to a worldwide customer base of manufacturers and distributors. This transaction substantially increased our presence in Southeast Asia and expanded our network of owned offices through which to deliver global supply chain solutions. The transaction was valued at up to \$6.2 million, consisting of cash of \$2.8 million, \$0.9 million of the Company's common stock paid at the closing and an additional \$2.5 million payable over a four-year earn-out period based upon the future financial performance of the acquired operations. We agreed to pay \$2.5 million in base earn-out payments payable in installments of \$0.3 million in 2004, \$0.6 million in 2005 through 2006 and \$1.0 million in 2007, with each installment payable in full if the acquired operations achieve pre-tax income of \$1.8 million in each of the years preceding the year of payment (or the pro rata portion thereof in 2003 and 2006). In the event there is a shortfall in pre-tax income, the earn-out payment will be reduced on a dollar-for-dollar basis. Shortfalls may be carried over or carried back to the extent that pre-tax income in any other payout year exceeds the \$1.8 million level. As additional purchase price, the Company also agreed to pay G-Link for excess net assets amounting to \$1.5 million through the issuance of Company common stock, on a post-closing basis. Based upon 2003 performance, G-Link received an earn-out payment of \$0.2 million on April 1, 2004.

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On February 9, 2004, through a wholly-owned subsidiary, we acquired a 55% interest in Shanghai-based Shaanxi Sunshine Cargo Services International Co., Ltd. ("Shaanxi"). Shaanxi provides a wide range of customized transportation and logistics services and supply chain solutions. The transaction is valued at up to \$11.0 million, consisting of cash of \$3.5 million and \$2.0 million of the Company's common stock paid at the closing, plus up to an additional \$5.5 million payable over a five-year period based upon the future financial performance of Shaanxi. The earn-out payments are due in five installments of \$1.1 million beginning in 2005, with each installment payable in full if Shaanxi achieves pre-tax income of at least \$4.0 million in each of the earn-out years. In the event there is a shortfall in pre-tax income, the earn-out payment for that year will be reduced on a dollar-for-dollar basis by the amount of the shortfall. Shortfalls may be carried over or back to the extent that pre-tax income in any other payout year exceeds the \$4.0 million level. As additional purchase price, on a post-closing basis the Company has agreed to pay Shaanxi for 55% of its closing date working capital. 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 \$4.0 million (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. Effective September 20, 2004, the Company amended the purchase agreement for a change in the settlement date for Shaanxi's closing date working capital from August 2004 to \$1.0 million on or before November 15, 2004, and an additional \$0.9 million on or before March 31, 2005. The amendment also fixed

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the date of distribution for collections in cash after the initial 180 day working capital assessment period from due when collected to March 31, 2005. As of September 30, 2004, the residual distribution is estimated at \$1.0 million bringing the total estimated March 31, 2005 distribution to \$1.9 million.

We may be required to make significant payments in the future if the earn-out installments under our various acquisitions become due subject to limitations within the U. S. Facility. While we believe that a significant portion of the required payments will be generated by the acquired subsidiaries, we may have to secure additional sources of capital to fund some portion of the earn-out payments as they become due. This presents us with certain business risks relative to the availability and pricing of future fund raising, as well as the potential dilution to our stockholders if the fund raising involves the sale of equity.

The following table summarizes our maximum possible contingent base earn-out payments for the years indicated based on results of the prior year as if pre-tax earning targets associated with each acquisition were achieved although the Company does not expect the Domestic Services pre-tax earnings levels to be fully achieved (in thousands) (1) (2):

	2005	2006	2007	2008	2009

Earn-out payments:					
Domestic	\$ 9,040	\$ 8,050	\$ 2,500	\$ 2,500	\$ --
International	3,904	3,904	4,276	2,542	2,010
	-----	-----	-----	-----	-----
Total earn-out payments	\$ 12,944	\$ 11,954	\$ 6,776	\$ 5,042	\$ 2,010
	=====	=====	=====	=====	=====
Prior year pre-tax earnings targets(3)					
Domestic	\$ 12,306	\$ 12,306	\$ 3,500	\$ 3,500	\$ --
International	10,546	10,546	11,602	6,940	5,823
	-----	-----	-----	-----	-----
Total pre-tax earnings targets	\$ 22,852	\$ 22,852	\$ 15,102	\$ 10,440	\$ 5,823
	=====	=====	=====	=====	=====
Earn-outs as a percentage of prior year pre-tax earnings targets:					
Domestic	73.5%	65.4%	71.4%	71.4%	--
International	37.0%	37.0%	36.9%	36.6%	34.5%
Combined	56.6%	52.3%	44.9%	48.3%	34.5%

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(1) Excludes the impact of prior year's pre-tax earnings carryforwards (excess or shortfalls versus earnings targets).

(2) During the 2003-2007 earn-out period, there is an additional contingent obligation related to tier-two earn-outs that could be as much as \$18.0 million if certain of the acquired companies generate an incremental \$37.0 million in pre-tax earnings.

(3) Aggregate pre-tax earnings targets as presented here identify the uniquely defined earnings targets of each acquisition and should not be interpreted

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to be the consolidated pre-tax earnings of the Company which would give effect for, among other things, amortization or impairment of intangible assets created in connection with each acquisition or various other expenses which may not be charged to the operating groups for purposes of calculating earn-outs.

The Company is a defendant in a number of legal proceedings. Although we believe that the claims asserted in these proceedings are without merit, and we intend to vigorously defend these matters, there is the possibility that the Company could incur material expenses in the defense and resolution of these matters. Furthermore, since the Company has not established any reserves in connection with such claims, any such liability, if at all, would be recorded as an expense in the period incurred or estimated. This amount, even if not material to the Company's overall financial condition, could adversely affect the Company's results of operations in the period recorded.

One of the Company's customers which is the subject of a Chapter 11 proceeding under the Bankruptcy Code, paid to the Company approximately \$1.3 million of pre-petition indebtedness for shipping and delivery charges pursuant to an order of a United States Bankruptcy Court authorizing the payment of such charges. One of the creditors in the Chapter 11 proceeding appealed other orders of the Bankruptcy Court authorizing the payment of pre-petition indebtedness to other creditors for other charges and those orders have been reversed by a court proceeding. While no action has been taken in the Bankruptcy Court to challenge the payment made to the Company, if such action were taken in the future and that action were successful, the Company could be required to return all or a substantial portion of the payments made by the customer.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio and its line of credit. The Company does not have any derivative financial instruments in its investment portfolio. The Company is averse to principal loss and ensures the safety and preservation of its invested funds by limiting default risk, market risk and reinvestment risk. The Company invests its excess cash in institutional money market accounts. The Company does not use interest rate derivative instruments to manage its exposure to interest rate changes. If market interest rates were to change by 10% from the levels at March 31, 2004, the change in interest expense would have had an immaterial impact on the Company's results of operations and cash flows.

The Company also has exposure to foreign currency fluctuations with respect to its offshore subsidiaries. The Company does not utilize derivative instruments to manage such exposure. A hypothetical change of 10% in the value of the U.S. dollar would have had an immaterial impact on the Company's results of operations.

Item 4. Controls and Procedures

In January 2004, the Company restated its consolidated statements of operations for the last three quarters of fiscal 2002, the first three quarters of fiscal 2003, and for the year ended December 31, 2002, as a result of an error discovered in the legacy accounting processes of Stonepath Logistics International Services, Inc. (f/k/a "Global Transportation Systems, Inc.") and Global Container Line, Inc., its wholly owned subsidiary. The Company determined that a process error existed which resulted in the failure to eliminate certain intercompany transactions in consolidation. This process error was embedded in the legacy accounting processes of Global Transportation Systems, Inc. for a

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period which began substantially before its acquisition by the Company in April 2002. The Company believes that the presence of this error, in and of itself, constitutes a reportable condition as defined under standards established by the American Institute of Certified Public Accountants.

In connection with the preparation of the Company's June 30, 2004 consolidated financial statements, the Company's management determined that Stonepath Logistics Domestic Services, Inc. ("SLDS") did not follow the Company's designed disclosure controls and procedures to report a potential weakness in the methodology used by SLDS to estimate its accrued cost of purchased transportation. Based on its initial analysis at that time, the Company recorded an immaterial increase to SLDS' cost of transportation in the second quarter of 2004. The Company's management believes that the failure of SLDS to follow the designed disclosure and control procedures in and of itself constitutes a material weakness as defined under standards established by the American Institute of Certified Public Accountants. The Company has implemented changes in its estimating procedures and its processes for recognizing differences between actual and estimated costs to assure the proper recognition of purchased transportation costs.

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On September 20, 2004, the Company announced, after having performed some additional analysis, that it had understated its accrued purchased transportation liability and related costs of purchased transportation for previously reported periods as a result of an error discovered in the accounting processes within certain subsidiary operations of the Domestic Services segment. The Company determined that the process error did not accurately account for the differences between the estimates and the actual freight costs incurred. This allowed for an accumulation of previously unrecorded purchased transportation costs to build up (such amounts should have been reflected as purchased transportation costs). In addition, the error resulted in the Company making earn-out payments to selling shareholders in amounts greater than what otherwise would have been owed. The Company believes that the presence of this error, in and of itself, constitutes a material weakness in internal controls as defined under standards established by the American Institute of Certified Public Accountants.

In the course of its review of the process error related to the under accrual of purchased transportation, the Company also identified two additional process errors related to revenue transactions and to the processing of loss and damage claims, all within the Domestic Services segment. At its Detroit location, the Company identified a billing error in which the operating unit was invoicing one of its automotive customers at rates which had been approved by a customer representative who did not have the authority to do so. This customer billing error caused the Company to overstate its revenues. This location also identified loss and damage claims in the fourth quarter of 2004 that related to the first quarter of 2004 and accordingly restated for those claims. At its Minneapolis location, the Company identified an accounting error related to revenue recognition and depreciation that originated during the second quarter of 2004. Upon billing to a customer for certain capital equipment purchased in connection with the launch of a new distribution center for that customer, the unit recognized the revenue immediately rather than over the two-year life of the contract and had depreciated the capital equipment over its useful life rather than matching it to the life of the contract. The Company believes that the presence of the billing error, the accounting error, and the error related to loss and damage claims each constitute a reportable condition as defined under standards established by the American Institute of Certified Public Accountants.

In response to the reportable conditions and material weakness in the

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preceding two paragraphs, the Company is taking the following actions. With regards to the purchased transportation accrual issue, the Company has altered its methods to recognize the difference between actual costs of transportation and estimates for such costs on a timely basis. With respect to the errors related to revenue recognition and loss and damage claims, management of the units in question have been advised as to the proper treatment of similar transactions in the future.

The Company has restated its financial statements for the first quarter of 2004, and years ended December 31, 2003, 2002 and 2001 to correct the processing errors related to its purchased transportation accrual, the customer billings, revenue recognition loss and damage claim costs and to reflect the related income tax effects. In addition, the amounts owed as of December 31, 2003 and 2002 under various earn-out provisions have been changed to reflect the impact of the restatement.

A material weakness in internal accounting control is a condition in which the specific control procedures or the degree of compliance with them do not reduce to relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned tasks. The Company has implemented changes in procedures for the reporting of purchased transportation and believes that these changes will assure the proper recognition of these costs. A reportable condition is a significant deficiency in the design or operation of internal controls, which could adversely affect an organization's ability to initiate, record, process and report financial data consistent with the assertions of management in the financial statements. To specifically respond to this matter, and in general to meet our obligations under Section 404 of the Sarbanes-Oxley Act of 2002, the Company commenced an overall review of its internal controls over financial reporting. As part of the assessment of its internal controls over financial reporting, the Company is focusing on its recent growth in terms of both size and complexity, coupled with the fact that its finance and accounting functions are largely decentralized. Although this review is not yet completed, the Company has initiated immediate changes in processes at each of these locations to correct the errors that occurred and to reduce the likelihood that similar errors could occur in the future. In addition, the Company has changed its organizational structure to require the senior financial representatives within the Domestic Services and International Services platforms to report directly to the Company's Chief Financial Officer.

As of the date of this Report, the Company believes it has a plan that, when completed, will eliminate the reportable conditions and material weaknesses described above.

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As of the end of the period covered by this report, the Company carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures in connection with the filing of its initial Annual Report on Form 10-K based upon the information available at that time and concluded that the Company's disclosure controls and procedures were effective. Subsequent to that evaluation, the Company discovered the reportable conditions and material weaknesses described above (other than the reportable condition described in the first paragraph of this Item 4A which was discovered prior to December 31, 2003) and has taken the remedial actions described above. In connection with the preparation of this Form 10-Q/A, the Company has carried out an additional evaluation of the effectiveness of the Company's disclosure controls and procedures. This evaluation was carried out under the supervision and with the

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participation of the Company's Chief Executive Officer and Chief Financial Officer. Based on that evaluation, taking into account the reportable conditions and material weaknesses described above, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were not effective as of the end of the period covered by this report. However, the Company believes that as a result of the remedial measures implemented by the Company, the Company's disclosure controls and procedures are now effective.

Disclosure controls and procedures are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in Company reports filed under the Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosures.

Other than as described above, there have been no changes in the Company's internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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Part II. OTHER INFORMATION

Item 1. Legal Proceedings

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 H. 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 statements 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.

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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, 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 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 relative 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.

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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 is not able to predict the outcome of any of the foregoing litigation 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 settled the suit brought by Emergent Capital Investment LLC

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("Emergent") in the United States District Court for the Southern District of New York in exchange for the payment by the Company of \$50,000 in November 2004.

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 these 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 legal proceedings.

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Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

Effective as of February 9, 2004, we issued 630,915 shares of our common stock to Andy Tsai in partial consideration for the acquisition of a controlling interest in Shaanxi. The shares were valued, for purposes of the acquisition, at \$2.0 million (\$3.17 per share), and were issued in a private placement transaction exempt from the registration requirements of the Securities Act of 1933 pursuant to Section 4(2) and Rule 506 thereunder as an issuer transaction not involving a public offering.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

Effective October 27, 2004, a subsidiary of the Company, Stonepath Holdings (Hong Kong) Limited ("Asia Holdings") entered into a Term Credit Agreement (the "Term Credit Agreement") with Hong Kong Central League Credit Union (the "Lender") and SBI Advisors, LLC, as agent for the Lender. The Term Credit Agreement provides Asia Holdings with the right to borrow an initial amount of \$3.0 million and up to an additional \$7.0 million upon the satisfaction of certain conditions. The obligations of Asia Holdings under the Term Credit Agreement are secured by floating charges on the foreign accounts receivable of three of its subsidiaries, Planet Logistics Express (Singapore) Pte. Ltd., GLink Express (Singapore) Pte. Ltd., and Stonepath Logistics (Hong Kong) Limited. Asia Holdings borrowed \$3.0 million on November 4, 2004 and \$2.0 million on February 16, 2005. There is no assurance that the remaining \$5.0 million will be available to Asia Holdings under the Term Credit Agreement. All borrowings under the Term Credit Agreement bear interest at an annual rate of 15% and must be repaid on or before November 4, 2005. The obligation to repay the borrowings under the Term Credit Agreement may be accelerated by the Lender upon the occurrence of events of default customary for loan transactions. Stonepath Group, Inc. has guaranteed the obligations of Asia Holdings under the Term Credit Agreement pursuant to the terms of the Guaranty dated as of October 27, 2004 (the "Guaranty") by Stonepath Group, Inc. in favor of the Lender.

On September 20, 2004, 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. Since September 20, 2004, the Company has analyzed its costs of purchased transportation, certain

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revenue transactions, loss and damage claims and the resulting income tax and other effects. In addition, as described in the next paragraph, the amount actually owed for certain earn-out payments was impacted. The effects of the restatements have been reflected in this Form 10-Q/A.

As a result of the restatement process, the Company has determined that it made earn-out payments to the former owners of its Air Plus and United American subsidiaries in excess of amounts due. These amounts have been reflected in the accompanying financial statements as other assets. A full valuation allowance has been provided for those advances due to the differing interpretation of the stock purchase agreements by the Company and the selling shareholders. The affect of this change reduced net income by \$3.1 million for the three-month period ended March 31, 2004 and \$1.3 million for the three-month period ended March 31, 2003. Goodwill has been reduced by similar amounts from that previously reported.

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Item 6. Exhibits and Reports on Form 8-K

(a) The following exhibits are included herein:

- 2.9 Amended and Restated Contract for the Sale of Assets by and between Stonepath Holdings (Hong Kong) Limited and Andy Tsai, dated November 10, 2003.(1)
- 2.10 Amendment Letter Agreement dated February 9, 2004, to the Amended and Restated Contract for the Sale of Assets by and between Stonepath Holdings (Hong Kong) Limited and Andy Tsai.(1)
- 10.14 Amendment to Executive Employment Agreement between Stonepath Logistics International Services, Inc. and Jason Totah dated April 1, 2004.(2)
- 12 Calculation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends.
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.)
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as

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amended.)

- (1) Incorporated by reference to the Company's Current Report on Form 8-K dated February 9, 2004.
- (2) Incorporated by reference to the Company's Form 10-Q for the first quarter ended March 31, 2004, filed on May 10, 2004.

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(b) Reports on Form 8-K:

On February 24, 2004, the Company filed a Current Report on Form 8-K dated February 9, 2004, reporting under Item 2 on the acquisition of a majority interest in Shaanxi Sunshine Cargo Services International Co., Ltd.

On February 26, 2004, the Company furnished under Items 9 and 12 of Form 8-K, a copy of its earnings release dated February 25, 2004.

On February 27, 2004, the Company furnished an amendment to its Form 8-K dated February 26, 2004, to correct certain typographical errors inadvertently contained in the summary financial data tables that accompanied the February 25, 2004 earnings release.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

STONEPATH GROUP, INC.

Date: March , 2005

/s/ Jason Totah

Jason Totah
Chief Executive Officer

Date: March , 2005

/s/ Thomas L. Scully

Thomas L. Scully
Chief Financial Officer,
Vice President and Controller
(Principal Financial and
Accounting Officer)

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