Stone Arcade Acquisition CORP
Form 10-Q/A
December 12, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 1

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2006.

or

o Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to .

Commission File Number: 000-51444

Stone Arcade Acquisition Corporation

(Exact name of registrant as specified in its charter)

Delaware	**20-2699372**

(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

c/o Stone-Kaplan Investments, LLC, One Northfield Plaza, Suite 480
Northfield, IL 60093
(Address of Principal Executive Offices including zip code)

(847) 441-0929
(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer x

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

There were 25,000,000 shares of the Registrant s Common Stock issued and outstanding on August 11, 2006.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A (Form 10-Q/A) to the Company s Quarterly Report on Form 10-Q for the period ended June 30, 2006, initially filed with the Securities and Exchange Commission on August 14, 2006 (the Original Filing), reflects changes to the notes to the financial statements relating to the exercise provisions of the Company s warrants and a change to Note G to reflect a restatement to the financial statements of the Kraft Paper Business division of International Paper Company. This Form 10-Q/A amends and restates (i) Item 1. Financial Statements; and (ii) Item 6. Exhibits. In addition, the Original Filing has been amended to contain currently dated certifications from the Company s Chief Executive Officer and Chief Financial Officer, as required by Sections 302 and 906 of the Sarbanes-Oxley Act (See Exhibits 31 and 32).

Except to the extent modified or updated, the foregoing items have not been amended to reflect other events occurring after the Original Filing or to modify or update those disclosures affected by subsequent events. Other events occurring after the filing of the Original Filing or other disclosures necessary to reflect subsequent events have been addressed in the Company s reports filed with the Securities and Exchange Commission subsequent to the filing of the Original Filing.

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Stone Arcade Acquisition Corporation
(a development stage company)
Condensed Consolidated Balance Sheet

	June 30, 2006 (unaudited)	**December 31, 2005**
Assets		
Current assets:		
Cash	$ 1,427,509	$ 2,157,611
Cash and investments, held in trust	113,608,480	111,965,034
Prepaid expenses	24,500	128,875
Total current assets	115,060,489	114,251,520
Acquisition cost	1,046,450	
Deferred income taxes	222,288	54,094
Total assets	$ 116,329,227	$ 114,305,614
Liabilities and Stockholders Equity		
Current liabilities:		
Accrued expenses	$ 876,668	$ 136,338
Deferred income taxes	42,058	90,521
Total current liabilities	918,726	226,859
Common stock, subject to possible redemption-3,998,000 shares	22,159,715	22,159,715
Interest income attributable to common stock subject to possible redemption (net of taxes of $266,050 and $97,061 at June 30, 2006 and December 31, 2005, respectively)	516,451	189,462
	22,676,166	22,349,177
Commitments and contingencies (Note E)		
Stockholders equity		
Preferred stock $.0001 par value; 1,000,000 shares authorized; 0 shares issued and outstanding		
Common stock $.0001 par value, 175,000,000 shares authorized; 25,000,000 shares issued and outstanding (including 3,998,000 shares subject to possible redemption)	2,500	2,500
Additional paid-in capital	91,098,761	91,098,761
Income accumulated during the development stage	1,633,074	628,317
Total stockholders equity	92,734,335	91,729,578
Total liabilities and stockholders equity	$ 116,329,227	$ 114,305,614

See notes to condensed unaudited financial statements.

Stone Arcade Acquisition Corporation
(a development stage company)
Condensed Consolidated Statement of Operations
(unaudited)

	Three Months Ended June 30, 2006	Six Months Ended June 30, 2006	Inception (April 15, 2005 Through June 30, 2005)	Accumulated Inception Through June 30, 2006
Cost and expenses:				
Operating expenses	$ 363,711	$ 518,168	$ 1,000	$ 739,268
Other income:				
Bank interest	21,128	48,363		72,503
Interest on cash and cash equivalents held in trust	1,298,603	2,478,433		3,914,451
Total other income	1,319,731	2,526,796		3,986,954
Income (loss) before provision for income taxes:	956,020	2,008,628	(1,000)	3,247,686
Provision for income taxes:				
Current	378,601	873,472		1,258,324
Deferred	(62,905)	(196,590)		(160,163)
Total provision for income taxes	315,696	676,882		1,098,161
Net income (loss)	640,324	1,331,746	(1,000)	2,149,525
Deferred interest, net of taxes, attributable to common stock subject to possible redemption	(171,330)	(326,989)		(516,451)
Net income (loss) allocable to holders of nonredeemable common stock	$ 468,994	$ 1,004,757	$ (1,000)	$ 1,633,074
Weighted-average number of shares outstanding:				
Basic	25,000,000	25,000,000	5,000,000	19,285,714
Diluted	29,221,825	29,028,777	5,000,000	21,788,321
Earnings per share:				
Basic	$ 0.03	$ 0.05	$	$ 0.11
Diluted	$ 0.02	$ 0.05	$	$ 0.10
Weighted-average number of shares outstanding exclusive of shares subject to possible redemption:				
Basic	21,002,000	21,002,000		16,430,000
Diluted	25,223,825	25,030,777		18,932,607
Earnings per share exclusive shares and related deferred interest subject to possible redemption:				
Basic	$ 0.02	$ 0.05		$ 0.10
Diluted	$ 0.02	$ 0.04		$ 0.09

See notes to condensed unaudited financial statements.

Stone Arcade Acquisition Corporation
(a development stage company)
Condensed Consolidated Statement of Cash Flows
(unaudited)

	Six Months Ended June 30, 2006	Inception (April 15, 2005 Through June 30, 2005)	Accumulated (Inception) Through June 30, 2006
Operating activities:			
Net income (loss)	$ 1,331,746	$ (1,000)	$ 2,149,525
Changes in			
Interest receivable on short term investments	142,540		(123,699)
Prepaid expenses	104,375		(24,500)
Accrued expenses	686,792	1,000	763,277
Accrued income taxes	53,539		113,391
Deferred income taxes	(216,657)		(180,230)
Net cash provided by operating activities	2,102,335		2,697,764
Investing activities:			
Acquisition cost	(1,046,450)		(1,046,450)
Purchase of U.S. government securities held in trust	(792,063,023)		(1,348,828,031)
Maturities of U.S. government securities held in trust	790,277,036		1,235,343,250
Net cash used in investing activities	(2,832,437)		(114,531,231)
Financing activities:			
Proceeds from public offering, net of expenses			113,235,876
Proceeds from sale of common stock to founding stockholders		25,000	25,000
Proceeds from notes payable to stockholders		200,000	200,000
Repayment of notes to stockholders			(200,000)
Payments of deferred offering costs		(186,976)	
Proceeds from issuance of underwriters option			100
Net cash provided by financing activities		38,024	113,260,976
Net (decrease) increase in cash	(730,102)	38,024	1,427,509
Cash-beginning of period	2,157,611		
Cash-end of period	$ 1,427,509	$ 38,024	$ 1,427,509

See notes to condensed unaudited financial statements.

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Stone Arcade Acquisition Corporation
(a development stage company)
Notes to Condensed Consolidated Unaudited Financial Statements

Note A. Basis of Presentation, Principles of Consolidation, Use of Estimates and Reclassifications

The accompanying unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary and are prepared in conformity with U.S. generally accepted accounting principles. The results of operations for the six month period ended June 30, 2006 are not necessarily indicative of the results to be expected for the year ending December 31, 2006.

The condensed balance sheet at December 31, 2005 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the financial statements and footnotes thereto included in Stone Arcade Acquisition Corporation s annual report on Form 10-K for the period ended December 31, 2005.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates.

Note B. Organization and Business Operations

Stone Arcade Acquisition Corporation (the Company) was incorporated in Delaware on April 15, 2005. On May 25, 2006, the Company formed a wholly-owned subsidiary, KapStone Kraft Paper Corporation, or KapStone Kraft. The Company was formed to serve as a vehicle for the acquisition through a merger, capital stock exchange, asset acquisition, or other similar business combination (Business Combination) of an operating business in the paper, packaging, forest products and related industries. The Company has neither engaged in any operations nor generated operating revenue. The Company is considered to be in the development stage and is subject to the risks associated with activities of development stage companies. The Company has selected December 31 as its fiscal year end.

The registration statement for the Company s initial public offering (the Offering) was declared effective on August 15, 2005. The Company consummated the Offering on August 19, 2005 and received net proceeds of approximately $113,236,000. The Company s management has broad discretion with respect to the specific application of the net proceeds of the Offering (as described in Note C), although substantially all of the net proceeds of the Offering are intended to be generally applied toward a Business Combination. Furthermore, there is no assurance that the Company will be able to successfully effect a Business Combination. As of June 30, 2006, of the net proceeds, $113,608,480, including interest earned of $3,914,451, net of taxes, is being held in a trust account (Trust Fund) and invested in U.S. Government securities until the earlier of (i) the consummation of the first Business Combination or (ii) the distribution of the Trust Fund as described below.

The interest income is subject to additional taxes incurred, but not yet paid as of June 30, 2006. The remaining proceeds may be used to pay for business, legal and accounting due diligence on prospective business combinations and continuing general and administrative expenses. The Company, after signing a definitive agreement for the acquisition of a target business, will submit such transaction for stockholder approval. In the event that holders of 20 percent or more of the shares issued in the Offering vote against the Business Combination and seek to have their shares redeemed, the Business Combination will not be consummated. If a majority of the shares voted at the meeting by public stockholders are voted in favor of the Business Combination and holders of less than 20 percent of the shares issued in the offering vote against the Business Combination and elect to have their shares redeemed, the Business Combination will be consummated and the shares of such holders will be redeemed for approximately $5.54 per share, plus interest allocable to such shares, net of income taxes. The number of shares subject to possible redemption is approximately 3,998,000. At June 30, 2006, the Company has classified $22,676,166 of the net proceeds from the Offering, inclusive of interest but net of taxes, as common stock subject to possible redemption in the accompanying balance sheet.

In the event that the Company does not consummate a Business Combination within 18 months from the effective date of the Offering, or 24 months from the effective date of the Offering if certain extension criteria have been satisfied (the Acquisition Period), the proceeds held in the Trust Fund will be distributed to the Company s public stockholders (i.e. excluding the persons who were stockholders prior to the Offering (the Founding Stockholders) to the extent of their initial stock holdings.) However, the Founding Stockholders will participate in any liquidation distribution with respect to any shares of common stock they acquired in connection with or following the Offering. In the event of such distribution, it is likely that the per share value of the residual assets remaining available for distribution (including Trust Fund assets) will be less than the initial public offering price per share in the Offering (assuming no value is attributed to the Warrants contained in the Units in the Offering discussed in Note C).

Note C. Initial Public Offering

On August 19, 2005, the Company sold 20,000,000 units (Units) for a gross price of $6.00 per Unit. Each Unit consists of one share of the Company s common stock, $.0001 par value, and two warrants (Warrants). Each Warrant entitles the holder to purchase from the Company one share of common stock at an exercise price of $5.00. Each warrant is exercisable on the later of (a) the completion of a Business Combination or (b) August 15, 2006, and expires on August 15, 2009. The Warrants are redeemable at a price of $.01 per Warrant upon 30 days notice after the Warrants become exercisable, only in the event that the last sale price of the common stock is at least $8.50 per share for any 20 trading days within a 30 trading day period ending on the third day prior to the date on which notice of redemption is given.

In connection with the Offering, the Company paid the underwriters an underwriting discount of five percent of the gross proceeds of the Offering. The Company also issued for $100 an option to the representative of the underwriters to purchase up to a total of 1,000,000 units at a price of $7.50 per unit. The units issuable upon the exercise of this option are identical to those offered in the prospectus, except that the exercise price of the warrants included in the underwriters purchase option is $6.25. This option is exercisable commencing on the later of the consummation of a Business Combination or one year from the date of the Offering, expires five years from the date of the Offering, and may be exercised on a cashless basis. The option may not be sold, transferred, assigned, pledged or hypothecated until August 16, 2006. However, the option may be transferred to any underwriter or selected dealer participating in the Offering and their bona fide officers or partners.

The underwriters purchase option and the Warrants (including the warrants underlying the underwriters option) will be exercisable only if at the time of exercise a current registration statement covering the underlying securities is effective or, in the opinion of counsel, not required, and if the securities are qualified for sale or exempt from qualification under the applicable state securities laws of the exercising holder. The Company is obligated to use its best efforts to maintain an effective registration statement during the term of the option and the Warrants; however, it may be unable to do so. Holders of the option and the Warrants are not entitled to receive a net cash settlement or other settlement in lieu of physical settlement if the common stock underlying the Warrants, or securities underlying the option, as applicable, are not covered by an effective registration statement. Accordingly, the Warrants, which do not have a cashless exercise provision, may expire unexercised and worthless if a current registration statement covering the common stock is not effective.

The holders of the option have demand and piggy-back registration rights under the Securities Act for periods of five and seven years, respectively, from the date of the prospectus with respect to registration of the securities directly and indirectly issuable upon exercise of the option. The exercise price and number of units issuable upon exercise of the option may be adjusted in certain circumstances, including issuances of a stock dividend, recapitalization, reorganization, merger or consolidation. However, the option will not be adjusted for issuances at a price below its exercise price.

The Company has estimated, based upon a Black Scholes model, that the fair value of the purchase option on the date of sale was approximately $980,000. The Company accounted for this purchase option, inclusive of the receipt of the $100 cash payment, as an expense of the Offering resulting in a charge directly to stockholders equity. Accordingly there was no impact in the Company s financial position or results of operations except for the recording of the $100 proceeds from the sale.

In accordance with a commitment entered into in connection with the Offering, the Founding Stockholders have purchased 3,500,000 warrants in the public marketplace. They have further agreed that such warrants will not be sold or transferred until the completion of a Business Combination.

Note D. Related-Party Transactions

The Company has agreed to pay Stone-Kaplan Investments, LLC, a company where certain of the Founding Stockholders serve in executive capacities, an administrative fee of $7,500 per month for office space and general

and administrative services from August 15, 2005 through the acquisition date of a target business. Stone-Kaplan Investments LLC has agreed to pay a portion of the aforementioned administration fee to Arcade Partners LLC, a company where certain of the Founding Stockholders serve in executive capacities. From time to time the Company retains the services of White Oak Aviation, an aviation services company solely owned by certain Founding Stockholders. For the three and six months ended June 30, 2006, the amount paid to this entity was $18,295 and $38,579, respectively.

The Founding Stockholders have agreed with the Company and the underwriters that if the Company liquidates prior to the consummation of a Business Combination, they will be personally liable to pay debts and obligations to vendors that are owed money by the Company for services rendered or products sold to us in excess of the net proceeds not held in the Trust Fund at that time.

Note E. Commitments and Contingencies

The Company has engaged the representative of the underwriters to act as its investment banker in connection with a Business Combination. The Company has agreed to pay the representative a cash fee of $1,200,000 at the closing of the Business Combination for assisting the Company in structuring and negotiating the terms of the transaction.

Note F. Common Stock Reserved for Issuance

At June 30, 2006, 43,000,000 shares of common stock were reserved for issuance upon exercise of warrants and the underwriter s option.

Note G. Purchase Agreement for Proposed Business Combination

On June 23, 2006, Stone, KapStone Kraft, and International Paper Company, or IP, entered into a Purchase Agreement. The Purchase Agreement provides for the acquisition of substantially all of the assets and the assumption of certain liabilities of the Kraft Papers Business, or KPB, a division of IP, consisting of an unbleached kraft paper manufacturing facility in Roanoke Rapids, North Carolina and Ride Rite® Converting, an inflatable dunnage bag manufacturer located in Fordyce, Arkansas, for a cash purchase price of $155 million plus two contingent earn-out payments of up to $35 million and $25 million, based on KPB s annual earnings before interest, income taxes, depreciation and amortization, or EBITDA, during the five years immediately following the acquisition. The purchase price payable on the closing date will be adjusted dollar-for-dollar to the extent IP s working capital as of such date is greater or less than $42,637,709.

KPB generated approximately $63.8 million in sales and $6.6 million in operating income for the three months ended March 31, 2006 and approximately $220.0 million in sales and $9.5 million in operating income for the year ended December 31, 2005.

The Company intends to use its proceeds of its initial public offering, which includes $113,608,480, including interest earned, currently held in the Trust Fund, together with borrowings from a $95,000,000 senior secured credit facility to be obtained in connection with the acquisition to acquire the KPB assets, to pay transaction expenses, and to pay holders of IPO shares who exercise their redemption rights.

The proposed acquisition is subject to, among other things, the approval of the transaction by the Company s stockholders. There can be no assurance that the transaction will be consummated.

PART II. OTHER INFORMATION

Item 6. EXHIBITS

(b) Exhibits

4.6 Amended and Restated Warrant Clarification Agreement, by and between Stone Arcade Acquisition Corp. and Continental Stock Transfer & Trust Company

31 Rule 13a-14(a) Certification of Principal Executive Officer and Principal Financial Officer.

32 18 U.S.C Section 1350 Certification.

SIGNATURES

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

	STONE ARCADE ACQUISITION CORPORATION	
December 12, 2006	By:	/s/ Roger Stone Roger Stone Chairman of the Board and Chief Executive Officer