STONEPATH GROUP INC
Form 10-Q
May 12, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2006

o **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.)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

There were 43,749,693 issued and outstanding shares of the registrant s common stock, par value $.001 per share, as of May 5, 2006.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	March 31, 2006 (UNAUDITED)	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 6,275	$ 4,601
Accounts receivable, net	58,969	69,836
Prepaid expenses and other current assets	2,098	2,312
Total current assets	67,342	76,749
Goodwill	44,179	43,762
Technology, furniture and equipment, net	6,451	6,856
Acquired intangibles, net	4,799	5,212
Other assets	2,986	2,703
Total assets	$ 125,757	$ 135,282
Liabilities and Stockholders Equity		
Current liabilities:		
Short-term debt	$ 17,313	$ 14,039
Accounts payable	39,994	50,054
Earn-outs payable	2,639	3,513
Accrued payroll and related expenses	3,505	3,393
Accrued restructuring costs	1,209	1,485
Accrued expenses	7,523	7,516
Total current liabilities	72,183	80,000
Long-term debt	2,008	1,137
Long-term earn-outs payable	2,255	2,255
Other long-term liabilities	4,532	4,210
Deferred tax liability	3,118	2,898
Total liabilities	84,096	90,500
Minority interest	6,464	6,478

Commitments and contingencies (Note 7)				
Convertible preferred stock, $100.00 par value, 48,000 shares authorized, 30,000 shares issued		1,804		1,804
Stockholders equity:				
Preferred stock, $.001 par value, 10,000,000 shares authorized; none issued				
Common stock, $.001 par value, 100,000,000 shares authorized; issued and outstanding: 43,749,693 shares at 2006 and 2005, respectively		44		44
Additional paid-in capital		223,034		222,779
Accumulated deficit		(190,050)		(186,581)
Accumulated other comprehensive income		365		258
Total stockholders equity		33,393		36,500
Total liabilities and stockholders equity	$	125,757	$	135,282

See accompanying notes to consolidated financial statements.

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

	Three months ended March 31,	
	2006	**2005**
Total revenue	$ 92,183	$ 89,990
Cost of transportation	72,667	69,576
Net revenue	19,516	20,414
Personnel costs	11,300	12,105
Other selling, general and administrative costs	8,458	10,170
Depreciation and amortization	935	1,158
Restructuring charges		3,341
Loss from operations	(1,177)	(6,360)
Other income (expense):		
Interest expense, net	(1,361)	(438)
Change in fair value of derivatives	(343)	
Other income (expense), net	(6)	41
Loss before income tax expense and minority interest	(2,887)	(6,757)
Income tax expense	357	536
Loss before minority interest	(3,244)	(7,293)
Minority interest	135	270
Net loss	(3,379)	(7,563)
Preferred stock dividends	90	
Net loss attributable to common stockholders	$ (3,469)	$ (7,563)
Basic and diluted loss per common share	$ (0.08)	$ (0.17)
Basic and diluted weighted average shares outstanding	43,750	43,266

See accompanying notes to consolidated financial statements.

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

	Three months ended March 31,	
	2006	**2005**
Cash flow from operating activities:		
Net loss	$ (3,469)	$ (7,563)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Deferred income taxes	220	180
Depreciation and amortization	935	1,158
Change in fair value of derivatives	343	
Amortization of loan discount and fees	478	
Minority interest in income of subsidiaries	136	270
Stock-based compensation	84	17
Gain on disposal of technology, furniture and equipment and other	(4)	(44)
Changes in assets and liabilities:		
Accounts receivable	10,867	6,437
Prepaid expenses and other assets	(143)	(8)
Accounts payable and accrued expenses	(10,238)	2,685
Net cash (used in) provided by operating activities	(791)	3,132
Cash flows from investing activities:		
Purchases of technology, furniture and equipment	(125)	(125)
Payment of earn-out	(95)	
Proceeds from sales of technology, furniture and equipment	17	49
Net cash used in investing activities	(203)	(76)
Cash flows from financing activities:		
Proceeds from credit facilities, net	2,756	279
Principal payments on capital leases	(46)	(209)
Payment to minority shareholder	(150)	
Net cash provided by financing activities	2,560	70
Effect of foreign currency translation	108	95
Net increase in cash and cash equivalents	1,674	3,221

Cash and cash equivalents at beginning of period		4,601		2,801
Cash and cash equivalents at end of period	$	6,275	$	6,022
Cash paid for interest	$	597	$	484
Cash paid for income taxes	$	60	$	8
Supplemental disclosure of non-cash investing and financing activities:				
Issuance of notes payable in connection with financing of earn-out payments	$	1,196	$	
Increase in goodwill related to accrued earn-out payments		417		
Issuance of warrants in connection with loan refinancing		171		
Issuance of common stock in connection with acquisitions				752

See accompanying notes to consolidated financial statements.

STONEPATH GROUP, INC.
Notes to Unaudited Consolidated Financial Statements
March 31, 2006

(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 and date certain transportation and distribution solutions is offered through its Domestic Services segment, where the Company manages and arranges the movement of raw materials, supplies, components and finished goods for its customers. These services are offered through the Company s domestic air and ground freight forwarding business. A 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 segment. In addition to these core service offerings, the Company also provides a broad range of supply chain management services, including warehousing, order fulfillment and inventory control. The Company serves a customer base of manufacturers, distributors and national retail chains through a network of owned offices in the United States, strategic locations in the Asia Pacific region, Germany and Brazil, and service partners strategically located around the world.

The accompanying unaudited consolidated financial statements were prepared in accordance with United States generally accepted accounting principles for interim financial information. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC) relating to interim financial statements. These statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly the Company s financial position, operations and cash flows for the periods indicated. While the Company believes that the disclosures presented are adequate to make the information not misleading, these unaudited consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2005. Interim operating results are not necessarily indicative of the results for a full year because our operating results are subject to seasonal trends when measured on a quarterly basis. The Company s first and second quarters are likely to be weaker as compared with other fiscal quarters, which the Company believes is consistent with the operating results of other supply chain service providers.

The Company has experienced losses from operations, and has an accumulated deficit. In view of these matters, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon future profitable operations of the Company and generation of cash flow sufficient to meet its obligations. The Company believes that operating improvements completed in 2005, cost reductions and other changes to the business planned for 2006 and the availability on its credit facilities will provide the Company with adequate liquidity to allow uninterrupted support for its business operations through March 31, 2007.

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

(2) Restructuring Charges

In late 2004, the Company commenced a restructuring program, engineered to accelerate the integration of its businesses and improve the Company s overall profitability. A summary of restructuring charges, cash payments and related liabilities is as follows for the three-month period ended March 31, 2006:

	Liability Balance January 1, 2006	Restructuring Charges	Cash Payments	Liability Balance, March 31, 2006
Personnel	$ 159	$	$ (92)	$ 67
Building leases	1,326		(184)	1,142
	$ 1,485	$	$ (276)	$ 1,209

Personnel charges primarily relate to contractual obligations incurred in 2005 with certain executives. Remaining lease termination costs relate to the 2005 vacating of certain Domestic facilities and vacating and relocating the Company s former corporate headquarters in Philadelphia. Remaining liabilities will be paid in periods through 2008.

(3) Stock-Based Compensation

At March 31, 2006, the Company had one stock-based employee compensation plan. The Amended and Restated Stonepath Group, Inc. 2000 Stock Incentive Plan, (the Stock Incentive Plan) covers 15,000,000 shares of common stock. Under its terms, employees, officers and directors of the Company and its subsidiaries are currently eligible to receive non-qualified and incentive stock options and restricted stock awards. Options granted generally vest over three to four years and expire ten years following the date of grant. The Board of Directors or a committee thereof determines the exercise price of options granted.

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Prior to January 1, 2006, the Company accounted for stock-based compensation under the recognition and measurement provisions of Accounting Principles Board (APB) No. 25, Accounting for Stock Issued to Employees, and related interpretations, as permitted by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*. No stock-based compensation was recognized in the Statement of Operations for the three-months ended March 31, 2005, as all outstanding unvested options granted under the plan at that time had an exercise price equal to the market value of the underlying common stock on the date of grant. The Company accounted for stock-based compensation to non-employees (including directors who provide services outside their capacity as members of the board) in accordance with SFAS No. 123 and Emerging Issues Task Force (EITF) Issue No. 96 18, *Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services*. In addition, the Company disclosed pro forma amounts illustrating the effect on net income or loss attributable to common stockholders and income or loss per share as if the fair value of options granted had been recognized in accordance with the provisions of SFAS No. 123.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), *Share Based Payment*, using the modified-prospective-transition method. SFAS No. 123(R) supersedes APB No. 25, and amends SFAS No. 95, *Statement of Cash Flows*. Generally the fair value approach in SFAS No. 123(R) is similar to the fair value approach described in SFAS No. 123. The Company uses the Black-Scholes formula to estimate the fair value of stock options granted to employees. Based on the terms of the stock option plan, the Company did not have a cumulative effect related to the implementation of SFAS No. 123(R) and therefore results for prior periods have not been restated. As of March 31, 2006, there was approximately $679,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under our plan. The cost is expected to be recognized over a weighted-average period of approximately 2.2 years. This expected cost does not include the impact of any future stock-based compensation awards. The Company recorded stock-based compensation expense of $84,000 for the three-months ended March 31, 2006. For the three-months ended March 31, 2005, the Company disclosed pro forma stock-based compensation expense of $356,000 in accordance of the provisions of SFAS No. 123.

(4) Acquired Intangible Assets

Information with respect to acquired intangible assets is as follows (in thousands):

	March 31, 2006		**December 31, 2005**	
	Gross Carrying Amount	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Amortizable intangible assets:				
Customer related	$ 11,042	$ 6,773	$ 11,042	$ 6,421
Covenants-not-to-compete	1,506	976	1,506	915
Total	$ 12,548	$ 7,749	$ 12,548	$ 7,336

Aggregate amortization expense:	
For the three-months ended March 31, 2006	$ 413
For the three-months ended March 31, 2005	516
Estimated aggregate amortization expense:	
For the remainder of the year ended December 31, 2006	$ 1,134
For the year ended December 31, 2007	1,254
For the year ended December 31, 2008	931

For the year ended December 31, 2009	607
For the year ended December 31, 2010	482

(5) Goodwill

The changes in the carrying amount of goodwill for the three-months ended March 31, 2006 are as follows (in thousands):

	Domestic Services	International Services	Total
Balance, December 31, 2005	$ 19,821	$ 23,941	$ 43,762
Adjustments to 2005 earn-out accruals	100	317	417
Balance, March 31, 2006	$ 19,921	$ 24,258	$ 44,179

Adjustments in 2006 to earn-out accruals for 2005 resulted from differences between actual performance used to compute earn-out payments to the selling shareholders and estimates used to compute accruals.

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(6) Credit Facilities

Short and long-term debt consists of the following (in thousands):

	March 31, 2006	December 31, 2005
Short-term debt		
U.S. Facility:		
Revolving note	$ 7,802	$ 6,045
Convertible minimum borrowing note, (net of discount of $3,753 and $4,075)	6,247	5,925
Total U.S. Facility	14,049	11,970
Note payable related party	1,897	1,897
Note payable earn-outs	1,196	
Capital lease obligations	171	172
Total short-term debt	$ 17,313	$ 14,039

	March 31, 2006	December 31, 2005
Long-term debt		
Offshore Credit Facilities, (net of discount of $83 as of March 31, 2006)	$ 1,917	$ 1,000
Capital lease obligations	91	137
Total long-term debt	$ 2,008	$ 1,137

U.S. Facility

In August 2005, the Company entered into several agreements with Laurus Master Fund, Inc. (Laurus), to provide a $25,000,000 U.S. Facility which replaced a previously outstanding facility. In connection with establishing the U.S. Facility with Laurus, the Company entered into two principal borrowing agreements and a warrant agreement, the terms of which are as follows:

Secured Convertible Minimum Borrowing Note (Minimum Borrowing Note) The Minimum Borrowing Note has a principal amount of $10,000,000, a three-year term expiring August 31, 2008 and bears interest at prime plus 1% subject to a minimum interest rate of 5.5%. The Minimum Borrowing Note is convertible into the Company s common stock at a conversion price of $1.0658 per share subject to customary antidilution adjustments. A total of 9,382,623 shares of the Company s common stock would be issued upon the full conversion of the principal of the Minimum Borrowing Note. Assuming the Company registered the shares necessary to complete the full conversion of the Minimum Borrowing Note, and if the market price of the Company s common stock for the last five trading dates of any month exceeds the conversion price of $1.0658 per share by 25%, then the interest rate for the next month will be reduced by 200 basis points for each incremental 25% increase in market price above $1.0658. The stated interest rate on the Minimum Borrowing Note was 8.75% and 8.25% as of, March 31, 2006 and December 31, 2005, respectively.

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

Secured Revolving Note (Revolving Note) The Revolving Note covers borrowings outstanding under the facility that are not represented by the Minimum Borrowing Note. The Revolving Note has a three-year term expiring August 31, 2008 and bears interest at prime plus 3.5% subject to a floor of 8.0% and prepayment premiums of 3% in the first year, 2% in the second year, and 1% in the third year of the Revolving Note. The stated interest rate on the Revolving Note was 11.25% and 10.75% as of March 31, 2006 and December 31, 2005 respectively.

Common Stock Purchase Warrants (Warrant) The Warrant entitles Laurus to purchase 2,500,000 shares of the Company s common stock for a period of five years, at an exercise price that varies with the number of shares purchased under the Warrant. The exercise price is $1.13 per share for the first 900,000 shares, $1.41 per share for the next 700,000 shares, $4.70 per share for the next 450,000 shares and $7.52 per share for the remaining 450,000 shares.

Registration Rights Agreement (Rights Agreement) The Rights Agreement provides that the Company file a registration statement for resale of the shares issuable upon conversion of the Minimum Borrowing Note or exercise of the Warrant by October 30, 2005, have the registration statement effective by December 30, 2005 and keep the registration statement effective for a period of five years. If the Company fails to meet the deadlines or if the registration statement is unavailable after it becomes effective, then the Company is subject to liquidated damages in the amount of $5,000 per day. The Company has filed a registration statement but it has not been declared effective. For the three-months ended March 31, 2006, liquidated damages of $450,000 were recorded and included in interest expense.

The Minimum Borrowing Note and Warrant require the Company to deliver registered shares as specified in the Rights Agreement. Under EITF Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock* , since the Company did not have an effective registration statement at inception of the agreements and is subject to liquidated damages in the event that effective registration does not occur or if effectiveness is not maintained, the conversion feature and Warrant are to be accounted for as derivatives that are recorded as liabilities, and measured at fair value at the inception of the contract with subsequent changes in fair value to be reflected in the consolidated statement of operations. The carrying value of the Minimum Borrowing Note was adjusted for the discount created by the initial fair value of the conversion feature and the allocated portion of the fair value of the Warrant in accordance with APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants.* The initial fair value of the derivatives were included in other long-term liabilities on the consolidated balance sheet with amounts allocated to the Company s debt recorded as a discount on such debt. The amount allocated to the Revolving Note is considered a debt issue cost and is classified in other assets on the consolidated balance sheet. This amount is being amortized on a straight-line basis over the three-year term of the agreement.

The derivatives have been measured at fair value as of March 31, 2006, resulting in a charge of $305,000 being recognized in the consolidated statement of operations for the three-months ended March 31, 2006. This charge represents the change in fair value of the derivatives from December 31, 2005 through March 31, 2006. In addition, interest expense of $323,000 resulting from the accretion of the discount utilizing the effective interest method was recognized in the three-months ended March 31, 2006.

The level of eligible accounts receivable of the Company limits the amounts available to be borrowed under the Minimum Borrowing Note and Revolving Note. The U.S. Facility generally provides for an advance rate of 90% of eligible accounts receivable. The U.S. Facility does not contain financial covenants although it does have affirmative and negative covenants, including the requirement for consent from the lender for certain actions, including future acquisitions, the payment of cash dividends or a merger. The Minimum Borrowing Note and Revolving Note are further secured by a global security interest in substantially all the assets of the Company s domestic subsidiaries, excluding any stock held in a foreign subsidiary.

As of March 31, 2006, the Company had $10,000,000 outstanding under the Minimum Borrowing Note and $7,802,000 outstanding under the Revolving Note. Based on the level of eligible receivables there was additional borrowing availability of $243,000 under the Revolving Note.

The U.S. Facility requires a lock-box arrangement, which provides for all receipts to be swept daily to reduce borrowings outstanding under the facility. This arrangement, combined with the existence of a subjective acceleration clause in the agreement, requires the classification of outstanding borrowings as a current liability in accordance with EITF Issue No. 95-22, *Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements that Include Both a Subjective Acceleration Clause and a Lock-Box Arrangement.* The acceleration clause allows Laurus to forego additional advances should they determine there has been a material adverse change in the Company s financial position or prospects reasonably likely to result in a material adverse effect on its business, condition (financial or otherwise), operations or properties.

Offshore Credit Facilities

In October 2005, the Company exchanged $3,000,000 of principal outstanding under a term credit agreement with Hong Kong League Central Credit Union (the Lender) and SBI Advisors, LLC, as agent for the Lender for 30,000 newly issued preferred shares of a subsidiary of the Company, Stonepath Holdings (Hong Kong) Limited (Asia Holdings) and extended the maturity date of $1,000,000 of outstanding principal under the agreement to November 4, 2007. The preferred shares are convertible into the Company s common stock at a conversion price of $1.08 per share. Dividends on the preferred shares accumulate at a rate of 12% payable monthly in cash or, at the option of the Company, payable in additional preferred shares. A total of 2,777,778 shares of the Company s common stock would be issued upon the full conversion of the preferred shares, assuming dividends are paid in cash. The $1,000,000 due is unsecured and bears interest at an annual rate of 12%. The Company also issued warrants to the Lender entitling the holder to purchase 277,778 shares of the Company s common stock at an exercise price of $1.13 per share for a period of four years.

The preferred shares contain mandatory redemption features that allow the holders to be repaid upon the occurrence of certain triggering events, including events of default on other debt agreements of the Company. Further, the amount to be repaid in the event of a triggering event is based upon the greater of 120% of the par value of the preferred shares or the market value of the number of common shares issuable under the conversion of the preferred shares. Since the preferred shares contain these redemption features, the proceeds received will not be considered permanent equity of the Company. Further, since the redemption provisions do not specify the ultimate amount of proceeds to be paid to the holder upon occurrence of a triggering event, the conversion feature must be accounted for as a derivative under the provisions of EITF Issue No. 00-19. The application of this accounting requires the derivative to be recorded as a liability and measured at fair value at the inception of the contract with subsequent changes in fair value to be reflected in the consolidated statement of operations. The carrying amount of the preferred shares was adjusted to record the discount created by the initial fair value of the derivative that amounted to $1,196,000. The initial fair value was recorded as a discount to the preferred stock, and a corresponding derivative liability was included in other liabilities on the consolidated balance sheet.

The derivative liability has been measured at fair value as of March 31, 2006, resulting in a charge of $38,000 being recognized in the consolidated statement of operations for the three-months ended March 31, 2006. This charge represents the change in fair value of the derivatives from December 31, 2005 through March 31, 2006.

On February 17, 2006, Asia Holdings entered into several additional term credit agreements providing proceeds of $1,000,000 with the right to borrow an additional $1,000,000 on a secured basis. The agreements bear interest at a rate of 10% and are to be repaid on or before February 28, 2009. In connection with these transactions, the Company also issued warrants entitling the lenders the right to acquire 500,000 shares at a price of $0.80 per share for a four-year term. The initial fair value of the warrants, as measured using the Black-Scholes option-pricing model was approximately $170,000, with $85,000 allocated to the initial borrowing and the remaining $85,000 allocated to debt issue costs for the unused portion of the agreement.

Other Debt

The Company has a note payable of $1,897,000 due the principal minority shareholder of its Shanghai, China subsidiary, Shaanxi Sunshine Cargo Services International Co. Ltd. (Shaanxi). This note, which was originally due on March 31, 2006, has been extended to June 30, 2006. Further, in connection with the extension, the interest rate on the note was increased from 10% to 15% per annum.

In March 2006, the Company extended the payment date of most of its earn-out payments for the 2005 earn-out performance measurement period from April 1, 2006 to June 30, 2006. This extension was accomplished through the issuance of notes payable to the various selling shareholders that carry interest rates at between 8% and 15% per annum. As of March 31, 2006, $1,196,000 of notes were issued for the earn-out payments due U.S.-based selling shareholders and are classified with short-term debt on the consolidated balance sheet. Notes for earn-out payments due in the amount of $1,267,000 were also issued in March 2006 to foreign-based selling shareholders, however, since the Company s foreign subsidiaries are included in the consolidated financial statements on a one-month lag basis, the issuance of these notes will be reflected on the Company s consolidated balance sheet in its reporting period ended June 30, 2006. Remaining earn-out payments classified as either short or long-term obligations are non-interest bearing and accordingly remain classified as earn-outs payable on the consolidated balance sheet.

Derivative Liabilities

The following is information regarding the Company s derivative instruments that are included in other long-term liabilities on the consolidated balance sheet (in thousands):

	Minimum Borrowing Note	Warrant	Preferred Shares	Total
Derivative liabilities recorded upon inception of contracts	$ 3,771	$ 1,294	$ 1,196	$ 6,261
Change in fair value of derivatives during 2005	(1,332)	(512)	(273)	(2,117)
Derivative liabilities as of December 31, 2005	2,439	782	923	4,144
Change in fair value of derivatives during the period	374	(69)	38	343
Derivative liabilities as of March 31, 2006	$ 2,813	$ 713	$ 961	$ 4,487

Significant assumptions used in Black-Scholes fair value calculations as of March 31, 2006: