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PALWEB CORP
Form 10QSB
October 20, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

(Mark One)

- QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED AUGUST 31, 2004
- TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission file number 000-26331

PALWEB CORPORATION

(Exact name of small business issuer as specified in its charter)

OKLAHOMA

75-2954680

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

1613 EAST 15TH STREET, TULSA, OKLAHOMA 74120

(Address of principal executive offices)

(918) 583-7441

(Issuer's telephone number)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: October 8, 2004 - 12,790,451

TRANSITIONAL SMALL BUSINESS DISCLOSURE FORMAT(CHECK ONE): Yes No

PALWEB CORPORATION

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FORM 10-QSB
FOR THE PERIOD ENDED FEBRUARY 29, 2004

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PALWEB CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

| | August 31, 2004 | May 31, 2004 |
|--|--------------------|-----------------|
| ASSETS | ----- | ----- |
| CURRENT ASSETS: | | |
| Cash | \$ 227,634 | \$ 274,085 |
| Accounts receivable | 1,060,541 | 951,596 |
| Inventory | 700,395 | 521,376 |
| TOTAL CURRENT ASSETS | 1,988,570 | 1,747,057 |
| PROPERTY, PLANT AND EQUIPMENT, at cost | 7,481,333 | 7,330,179 |
| Less: Accumulated depreciation | (851,062) | (741,151) |
| TOTAL PROPERTY, PLANT AND EQUIPMENT | 6,630,271 | 6,589,028 |
| OTHER ASSETS: | | |
| Goodwill | 6,164,435 | 6,164,435 |
| Patents and deposit | 487,582 | 490,441 |

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| | | |
|--------------------|---------------|---------------|
| TOTAL OTHER ASSETS | 6,652,017 | 6,654,876 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 15,270,858 | \$ 14,990,961 |
| | ===== | ===== |

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

| | | |
|--|--------------|--------------|
| Current portion of long-term debt | \$ 1,532,463 | \$ 2,352,667 |
| Notes payable | 2,928,628 | 1,503,612 |
| Accounts payable and accrued liabilities | 1,810,061 | 1,578,917 |
| Preferred dividends payable | 62,295 | 60,582 |
| TOTAL CURRENT LIABILITIES | 6,333,447 | 5,495,778 |
| | ----- | ----- |

| | | |
|--|-----------|-----------|
| LONG-TERM DEBT, NET OF CURRENT PORTION | 6,182,468 | 6,390,499 |
|--|-----------|-----------|

STOCKHOLDERS' EQUITY:

| | | |
|--|---|---|
| Preferred stock, \$.0001 par value, 20,750,000 shares authorized; 50,000 shares of Series 2003 outstanding | 5 | 5 |
|--|---|---|

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| | | |
|---|--------------|--------------|
| Common stock, \$.0001 par value, 5,000,000,000 authorized; outstanding - 12,790,451 | 1,279 | 1,279 |
| Additional paid-in capital | 48,265,496 | 48,265,496 |
| Deficit | (45,511,837) | (45,162,096) |
| TOTAL STOCKHOLDERS' EQUITY | 2,754,943 | 3,104,684 |
| | ----- | ----- |

| | | |
|--|---------------|---------------|
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 15,270,858 | \$ 14,990,961 |
| | ===== | ===== |

The accompanying notes are an integral part of this consolidated financial statement.

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PALWEB CORPORATION CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

| | Three Months Ended August 31, | |
|--|----------------------------------|--------------|
| | 2004 | 2003 |
| SALES | \$ 2,170,230 | \$ 193,219 |
| COST OF SALES, including depreciation of \$109,911 and \$41,351, respectively | 1,910,568 | 385,915 |
| GROSS PROFIT (LOSS) | 259,662 | (192,696) |
| EXPENSES: | | |
| General and administrative expenses | 337,920 | 235,912 |
| OPERATING LOSS | (78,258) | (428,608) |
| OTHER INCOME (EXPENSE): | | |
| Other income | 8,006 | 3,656 |
| Interest expense | (187,400) | (175,934) |
| TOTAL OTHER INCOME (EXPENSE) | (179,394) | (172,278) |
| NET LOSS | (257,652) | (600,886) |
| PREFERRED DIVIDENDS | 92,089 | 224,384 |
| NET LOSS TO COMMON STOCKHOLDERS | \$ (349,741) | \$ (825,270) |
| NET LOSS PER COMMON SHARE | \$ (0.03) | \$ (0.13) |
| WEIGHTED AVERAGE SHARES OUTSTANDING | 12,790,000 | 6,317,000 |

The accompanying notes are an integral part of this consolidated financial statement.

PALWEB CORPORATION CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Three Months Ended
August 31,

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| | 2004 | 2003 |
|---|--------------|--------------|
| | ----- | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net cash used in operations | \$ (292,078) | \$ (243,126) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (151,154) | (550) |
| | ----- | ----- |
| Net cash used in investing activities | (151,154) | (550) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from borrowings | 925,000 | 243,676 |
| Payments on notes | (528,219) | -- |
| | ----- | ----- |
| Net cash provided by financing activities | 396,781 | 243,676 |
| | ----- | ----- |
| NET DECREASE IN CASH | (46,451) | -- |
| CASH, beginning of period | 274,085 | 6,209 |
| | ----- | ----- |
| CASH, end of period | \$ 227,634 | \$ 6,209 |
| | ===== | ===== |
| NONCASH ACTIVITIES: | | |
| Issuance of common stock in lieu of cash payment of preferred dividends | \$ -- | \$ 224,384 |
| SUPPLEMENTAL INFORMATION: | | |
| Interest paid | \$ 148,122 | \$ 150,932 |

The accompanying notes are an integral part of this consolidated financial statement.

PALWEB CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. In the opinion of the Company, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications, which are of a normal recurring nature, necessary to present fairly its financial position as of August 31, 2004, and the results of its operations and its cash flows for the three month periods ended August 31, 2004 and 2003. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements as of and for the year ended May 31, 2004 and the notes thereto included in the Company's Form 10-KSB. The financial statements have been prepared assuming that

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PalWeb will continue as a going concern. The working capital deficit of approximately \$4,232,000 at August 31, 2004, reflects the uncertain financial condition of PalWeb and its inability to obtain long term financing until it is able to attain profitable operations.

2. The results of operations for the three month period ended August 31, 2004 are not necessarily indicative of the results to be expected for the full year.

3. The computation of loss per share is computed by dividing the loss available to common shareholders by the weighted average shares outstanding for the periods. Loss available to common shareholders is determined by adding preferred dividends for the periods to the net loss. For the three month periods ended August 31, 2004 and 2003, the weighted average common shares outstanding are 12,790,000 and 6,317,000. Convertible preferred stock is not considered as its effect is antidilutive.

4. During the three month period ended August 31, 2004, PalWeb received advances totaling \$925,000 from certain unrelated parties of which one individual, Robert Rosene, was subsequently named as a member of the Board of Directors. The advances are unsecured loans for which interest is being accrued at the rate of 7.5% per annum.

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ITEM 2. MANAGEMENT DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

RESULTS OF OPERATIONS

GENERAL TO ALL PERIODS

The consolidated statements include PalWeb and its wholly-owned subsidiaries, Greystone Manufacturing, LLC, or GSM, and Plastic Pallet Production, Inc., or PPP.

PalWeb has incurred significant losses from operations, and there is no assurance that it will achieve profitability or obtain funds necessary to finance its operations.

References to fiscal year 2005 refer to the three month period ended August 31, 2004. References to fiscal year 2004 refer to the three month period ended August 31, 2003.

SALES

PalWeb's primary business is the manufacturing and selling of plastic pallets through its wholly owned subsidiaries, GSM and PPP. GSM is a newly formed subsidiary of PalWeb that acquired substantially all the assets and operations of Greystone Plastics, Inc, effective as of September 8, 2003. GSM manufactures pallets for the beverage industry, operates at full capacity and sells its product to one customer. PalWeb distributes its pallets through the combination of a network of independent contractor distributors and sales by PalWeb's officers and employees.

PPP also markets its own designed injection molding machine, the PIPER 600, through a licensing agreement with ForcePro, LLC, which gives ForcePro the exclusive right to market and sell the PIPER 600. Pursuant to the terms of the

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licensing agreement, PalWeb will receive a royalty of 5% of the gross proceeds from sales of the PIPER 600.

PERSONNEL

PalWeb has approximately 62 full-time employees as of August 31, 2004 compared to 14 full-time employees as of August 31, 2003. The increase in employees is due to the acquisition of the assets of Greystone Plastics, Inc.

TAXES

For all years presented, PalWeb's effective tax rate is 0%. PalWeb has generated net operating losses since inception, which would normally reflect a tax benefit in the statement of operations and a deferred asset on the balance sheet. However, because of the current uncertainty as to PalWeb's ability to achieve profitability, a valuation reserve has been established that offsets the amount of any tax benefit available for each period presented in the consolidated statement of operations.

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THREE MONTH PERIOD ENDED AUGUST 31, 2004, COMPARED TO THREE MONTH PERIOD ENDED AUGUST 31, 2003

Sales for fiscal year 2005 were \$2,170,230 compared to \$193,219 in 2004. The increase of \$1,977,011 is primarily attributable to the acquisition of the assets of Greystone Plastics, Inc. effective as of September 8, 2003. PalWeb currently utilizes a total of seven production lines to produce its plastic pallets, of which four production lines are utilized by PPP and remaining three are utilized by GSM. PalWeb anticipates that it will install an additional production line in about November 2004 that will be utilized by GSM. The GSM production lines operate at approximately full capacity, and it is expected that the new line will also operate at approximately full capacity.

Cost of sales in fiscal year 2005 was \$1,910,568, or 88% of sales, compared to \$385,915, or 200% of sales, in 2004. The decline of 112% from fiscal year 2004 to 2005 is primarily attributable to the acquisition of the assets and operations of Greystone Plastics, Inc. as discussed in the preceding paragraph.

General and administrative expenses increased \$102,008 from \$235,912 in fiscal year 2004 to \$337,920 in fiscal year 2005. This increase is principally due to an increase of three persons charged to administrative salaries.

Interest expense increased \$11,466 from \$175,934 in fiscal year 2004 to \$187,400 in fiscal year 2005.

The net loss decreased \$343,234 from \$(600,886) in fiscal year 2004 to \$(257,652) in fiscal year 2005 for the reasons discussed above.

After deducting preferred dividends, the net loss available to common shareholders is \$(349,741), or \$(0.03) per share, in fiscal year 2005 compared to \$(825,270), or \$(0.13) per share, in fiscal year 2004 for a decrease of \$475,529. Approximately \$0.07 of the decrease in the per share amounts is attributable to the increase in the weighted average number of shares of common stock outstanding for the quarter ended August 31, 2004 compared to the quarter ended August 31, 2003 due principally to the conversion of 750,000 shares of Series 2001 preferred stock converted into 5,250,000 shares of common stock effective as of September 8, 2003.

LIQUIDITY AND CAPITAL RESOURCES

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GENERAL

PalWeb's cash requirements for operating activities consist principally of accounts receivable, inventory, accounts payable requirements, operating leases and scheduled payments of interest on outstanding indebtedness. PalWeb is currently dependent on outside sources of cash to

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fund its operations. As of August 31, 2004, revenues from sales remain insufficient to meet current liabilities.

A summary of cash flows for the three months ended August 31, 2004 is as follows:

| | |
|---------------------------------------|--------------|
| Cash used in operating activities | \$ (292,078) |
| Cash used in investing activities | (151,154) |
| Cash provided by financing activities | 396,781 |

Contractual obligations of PalWeb are as follows:

| | TOTAL | LESS THAN 1 YEAR | 1-3 YEARS | 4-5 YEARS | OVER 5 YEARS |
|------------------|--------------|---------------------|--------------|--------------|-----------------|
| | ----- | ----- | ----- | ----- | ----- |
| Long-term debt | \$ 7,714,931 | \$ 1,532,463 | \$ 2,891,845 | \$ 1,760,364 | \$ 1,530,259 |
| Operating leases | 6,124,050 | 717,390 | 1,182,660 | 1,152,000 | 3,072,000 |
| | ----- | ----- | ----- | ----- | ----- |
| Total | \$13,838,981 | \$ 2,249,853 | \$ 4,074,505 | \$ 2,912,364 | \$ 4,602,259 |
| | ===== | ===== | ===== | ===== | ===== |

PalWeb anticipates that the cash necessary for funding its operating activities will continue to decline in fiscal 2005 as compared to fiscal 2004 based on its projection of increased sales activities for fiscal 2005. To provide for the additional cash to meet PalWeb's operating activities and contractual obligations for fiscal 2005, PalWeb is exploring various options including long-term debt and equity financing. However, there is no guarantee that PalWeb will be able to raise sufficient capital to meet these obligations.

PalWeb has accumulated a working capital deficit of approximately \$4,232,000 at August 31, 2004, which includes approximately \$4,461,000 of notes payable and current portion of long-term debt and \$1,872,000 in accounts payable and accrued liabilities. The working capital deficit reflects the uncertain financial condition of PalWeb resulting from its inability to obtain long term financing until such time as it is able to achieve profitability. There is no assurance that PalWeb will secure such financing.

PalWeb has had difficulty in obtaining financing from traditional financing sources. Substantially all of the financing that PalWeb has received through August 31, 2004, has been provided by loans from entities controlled by Mr. Paul Kruger, a significant shareholder, entities affiliated with Warren Kruger, President and Chief Executive Officer of PalWeb, through the offering of preferred stock to essentially the same persons and advances from individual investors principally through contacts of Warren Kruger. PalWeb has

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traditionally been reliant on funds provided by Warren Kruger and its board of directors through loans or the purchase of equity securities. There is no assurance that Warren Kruger will continue to provide loans or loan guarantees or purchase of equity securities of PalWeb in the future.

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ADVANCES FROM UNRELATED PARTIES

During the three month period ended August 31, 2004, PalWeb has received advances totaling \$925,000 from certain unrelated parties of which one individual, Robert Rosene, was later named as a member of the Board of Directors. Interest expense is being accrued on these advances at the rate of 7.5%.

LOANS FROM WARREN KRUGER

At August 31, 2004, Warren Kruger or entities owned by Warren Kruger had a note and advances totaling \$791,171 due from PalWeb. Interest is accrued at 7.5% on the note and advances.

At August 31, 2004, Westgate Capital LP, an entity controlled by Warren Kruger, had an unsecured note \$204,290 due from PalWeb. The note has an interest rate of 7.5% and matures October 1, 2004.

WORKING CAPITAL LOAN

On September 30, 2003, PalWeb entered into a loan agreement with BancFirst providing for a \$900,000 line of credit at the prime rate of interest plus 1% and a maturity of September 25, 2004. As of August 31, 2004, PalWeb had drawn \$899,980 on the line of credit. The loan is secured by accounts receivable and inventory of its subsidiary, Greystone Manufacturing, LLC.

MATERIAL RISKS

PalWeb has incurred significant losses from operations and there is no assurance that it will achieve profitability or obtain funds to finance continued operations. For other material risks, see PalWeb's Form 10-KSB for the period ended May 31, 2004, which was filed on August 30, 2004.

ITEM 3. CONTROLS AND PROCEDURES

PalWeb carried out an evaluation under the supervision of PalWeb's Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of PalWeb's disclosure controls and procedures pursuant to the Securities Exchange Act Rules 13a-15(e) and 15d-15(e). Based on this evaluation, PalWeb's Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures as of the end of the period covered by this report on Form 10-QSB are effective. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events and there can be no assurance that any design will succeed in adhering to its stated goals under all potential future conditions. During the first quarter ended August 31, 2004, there have been no material changes in PalWeb's internal controls over financial reporting.

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PART II. OTHER INFORMATION

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ITEM 6. EXHIBITS

- 11.1 Computation of Loss per Share is in Note 3 in the Notes to the financial statements.
- 31.1 Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, and Item 601(b)(31) of Regulation S-B, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (submitted herewith).
- 31.2 Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, and Item 601(b)(31) of Regulation S-B, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (submitted herewith).
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (submitted herewith).
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (submitted herewith).

SIGNATURE

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.

PALWEB CORPORATION

(Registrant)

Date: October 19, 2004

/s/ Warren F. Kruger

Warren F. Kruger
President and CEO