

Edgar Filing: PACEL CORP - Form 10QSB

PACEL CORP  
Form 10QSB  
August 20, 2004

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2004

OR

TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission File Number: 0-29459

PACEL CORP.

-----  
(Exact name of registrant as specified in its charter)

VIRGINIA

54-1712558

-----  
(State or other jurisdiction of incorporation or organization)

-----  
(I.R.S. Employer Identification Number)

10108 Industrial Drive  
Pineville, NORTH CAROLINA

28134-6516

-----  
(Address of principal executive offices)

-----  
(ZIP Code)

Registrant's telephone number, including area code: (704) 643-0676

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 day:

Yes  No

Transitional Small Business Disclosure Format (check one)

Yes  No

State the number of Shares outstanding of each of the issuer's classes of common equity, as of the latest date:

## Edgar Filing: PACEL CORP - Form 10QSB

As of August 19, 2004 there were 1,391,744,739 shares of the Registrant's common stock outstanding.

### PACEL CORP. AND SUBSIDIARIES

Part I. FINANCIAL INFORMATION (unaudited)		
Item 1.	Index to Consolidated Financial Statements	
	Consolidated Balance Sheets	F - 2
	Consolidated Statements of Operations	F - 4
	Consolidated Statements of Cash Flows	F - 5
	Notes to Consolidated Financial Statements	F - 7
Item 2.	Management's Discussion and Analysis of Financial Results of Operations	3
Item 3.	Controls and Procedures	9
Part II. OTHER INFORMATION		
Item 1.	Legal Proceedings	10
Item 2.	Changes in Securities	10
Item 3.	Defaults upon Senior Securities	10
Item 4.	Submission of Matters to Vote of Security Holders	10
Item 5.	Other Information	11
Item 6.	Exhibits and Reports	11
Item 7.	Signatures	12

### PACEL CORP. AND SUBSIDIARIES Consolidated Balance Sheets

		June 30, 2004
		-----
		(Unaudited)
ASSETS		
Current assets:		
Cash	\$	243,520
Cash CD-Restricted		600,000
Trust account - client deposits and advance payments		145,942
Accounts receivable		9,318
Stock subscription receivable		-0-
Prepaid expenses		122,407
Workers compensation insurance deposits		304,300
		-----
Total current assets		1,425,487
		-----

Edgar Filing: PACEL CORP - Form 10QSB

Property and equipment, net of accumulated depreciation of \$167,074 and \$153,578, respectively	187,995
	-----
Other assets:	
Other receivables	-0-
Retirement Plan-Director	58,175
Goodwill	1,075,432
Security deposits	12,905
	-----
Total other assets	1,146,512
	-----
Total assets	\$ 2,759,994
	=====

See accompanying notes to the consolidated financial statements.

F-2

PACEL CORP. AND SUBSIDIARIES  
Consolidated Balance Sheets

June 30,  
2004

-----  
(Unaudited)

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current liabilities:	
Accounts payable	\$ 931,794
Payroll and payroll related liabilities	1,980,689
Accrued expenses	548,067
Accrued expenses - officers	47,578
Assumed Liabilities	550,759
Client deposits and advance payments	145,942
Notes payable	533,000
Convertible Notes Payable	908,595
Notes payable - bank	29,538
Capital leases	6,187
Income taxes payable	-0-
	-----

Edgar Filing: PACEL CORP - Form 10QSB

Total current liabilities	5,682,149
Long-term liabilities:	
Deferred Compensation-Director Payable	58,175
	-----
Total liabilities	5,740,324
Stockholders' equity (deficit):	
Preferred stock, no par value, no liquidation value, 5,000,000 shares authorized, 1,000,000 shares of 1997 Class A convertible preferred stock	11,320
Common stock, no par value, 2,000,000,000 shares authorized, 386,887,751 and 16,757,368 shares issued respectively	20,768,394
Cumulative currency translation adjustment	(18,720)
Accumulated deficit	(23,741,324)
	-----
Total stockholders' (deficit)	(2,980,330)
	-----
Total liabilities and stockholders' deficit	\$ 2,759,994
	=====

See accompanying notes to the consolidated financial statements.

F-3

PACEL CORP. AND SUBSIDIARIES  
Consolidated Statements of Operations  
(Unaudited)

	Six months ended June 30,		Three
	2004	2003	2004
	-----	-----	-----
Revenue	\$ 1,971,154	\$ 1,147,420	\$ 1,022,2
Cost of services	1,537,680	913,702	778,7
	-----	-----	-----
Gross profit	433,474	233,718	243,4
Operating costs and expenses:			
General and administrative	1,436,210	1,138,255	651,8
Depreciation and amortization	13,496	8,908	6,9
Interest expense	106,181	91,723	65,0
Financing costs	1,355,714	130,750	1,110,7

Edgar Filing: PACEL CORP - Form 10QSB

Total operating expenses	2,911,601	1,369,636	1,834,5
Net loss from Continuing operations	\$ (2,478,127)	\$ (1,135,918)	\$ (1,591,1
Net loss per common and common equivalent share:			
Basic	\$ (0.03)	\$ (0.95)	\$ (0.
Diluted	\$ (0.03)	\$ (0.95)	\$ (0.
Weighted average shares outstanding:			
Basic	74,490,264	1,198,908	127,269,2
Diluted	74,490,264	1,198,908	127,269,2

See accompanying notes to the consolidated financial statements.

F-4

PACEL CORP. AND SUBSIDIARIES  
Consolidated Statements of Cash Flows  
(Unaudited)

	Six months ended June 30,	
	2004	2003
Cash flows from operating activities:		
Net loss	\$ (2,478,127)	\$ (1,135,918)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	13,496	8,908
Other non-cash items	1,545,714	492,765
Increase (decrease) in cash from changes in:		
Accounts receivable	61,071	(12,000)
Other receivables	82,901	7,590
Insurance deposits	(171,450)	(12,485)
Prepaid expenses	(78,080)	(7,406)
Security deposits	(3,540)	-0-

Edgar Filing: PACEL CORP - Form 10QSB

Accounts payable	(187,749)	(573,164)
Accrued expenses	(11,161)	121,331
Accrued expenses-Officers	(204,005)	-0-
Payroll and payroll related liabilities	(432,555)	582,205
Assumed liabilities	(565,622)	(3,407)
Income taxes payable	(2,532)	-0-
	-----	-----
Net cash (used in) operating activities	(2,431,639)	(1,040,345)
Cash flows from investing activities:		
(Purchases)/disposals of property and equipment	(104,137)	2,762
Cash CD-Restricted	(600,000)	-0-
Investment in Benecorp	-0-	160,744
Cash used for acquisitions	-0-	(105,000)
	-----	-----
Net cash (used in) investing activities	(704,137)	58,506
Cash flows from financing activities:		
Repayments of notes payable	(62,218)	(22,610)
Issuance of notes payable	90,000	-0-
Issuance of convertible notes payable	2,680,898	1,293,695
Borrowings/(repayments) from lines of credit	(4,362)	9,049
Repayments of capital lease	(7,422)	-0-
	-----	-----
Net cash provided by financing activities	2,696,896	1,280,134
Net increase (decrease) in cash and cash equivalents	(438,880)	298,295
Cash and cash equivalents, beginning of period	682,400	8,379
	-----	-----
Cash and cash equivalents, end of period	\$ 243,520	\$ 306,674
	=====	=====

See accompanying notes to the consolidated financial statements.

F-5

PACEL CORP. AND SUBSIDIARIES  
Consolidated Statements of Cash Flows  
(Unaudited)

	Six months ended	
	June 30,	
	2004	2003
	-----	-----
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 27,335	\$ 9,862
	=====	=====

[Balance of this page intentionally left blank]

See accompanying notes to the consolidated financial statements.

F-6

PACEL CORP. AND SUBSIDIARIES  
Notes to the Consolidated Financial Statements  
June 30, 2004

Note 1. Basis of Presentation.

The unaudited financial statements included in the Form 10-QSB have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Item 310(b) of Regulation SB of the Securities and Exchange Act of 1934. The financial information furnished herein reflects all adjustments, which in the opinion of management, are necessary for a fair presentation of the Company's financial position, the results of operations and cash flows for the periods presented.

Certain information and footnote disclosures normally contained in financial statements prepared in accordance with generally accepted accounting principles have been omitted, pursuant to such rules and regulations.

## Edgar Filing: PACEL CORP - Form 10QSB

These interim statements should be read in conjunction with the audited consolidated financial statements and related notes thereto as presented in the Company's certified financial statements for the year ended December 31, 2003. The Company presumes that users of the interim financial information herein have read or have access to such audited financial statements and that the adequacy of additional disclosure needed for a fair presentation may be determined in that context. The results of operations for any interim period are not necessarily indicative of the results expected or reported for the full year.

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

### Note 2. Related Party Transactions.

- a) The Company made payments to David Calkins for accrued payroll and loans. The balance due to Mr. Calkins was \$47,578 and \$251,583 at June 30, 2004 and December 31, 2003 respectively.
- b) Due to existing credit issues and the SEC lawsuit, Pacel Corp. found that it was becoming extremely difficult to obtain funds for acquisitions. Therefore, the Officers and Board of Directors began exploring alternative means by which to secure adequate financing for acquisitions. The Board of Directors decided, and the officers of the company agreed, that Kay Calkins would form a new company independent of Pacel in 2004 (referred to as "Newco"). In May 2004 Newco was formed and its corporate name is Piedmont HR Inc. The purpose of forming Piedmont HR was to acquire businesses in the HRO industry in markets where Pacel did not do business, and to benefit Pacel shareholders through administrative services and management contracts and leases of Pacel technology, operations, and processes to operate the companies acquired. In the event that Piedmont HR successfully acquired a company or its assets/operations, Piedmont HR would have executed a service agreement with Pacel to perform all or the majority of the administrative, management and operational services necessary to operate the acquired business. To date, Piedmont HR has not completed any acquisitions or hired any employees nor does Piedmont HR anticipate acquiring any companies. The Board of Directors and Officers have determined that Piedmont HR will not offer the growth potential equal to the growth potential from Pacel aggressive marketing strategy. Piedmont HR no longer fits Pacel's strategic business model and is being dissolved.

F-7

PACEL CORP. AND SUBSIDIARIES  
Notes to the Consolidated Financial Statements  
June 30, 2004

### Note 3. Accounting for Business Combinations.

In July 2001, the Financial Accounting Standards Board (the "FASB") issued



## Edgar Filing: PACEL CORP - Form 10QSB

Statement of Financial Accounting Standards No. 141, Business Combinations and Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (collectively, the "Statements"). These Statements change the accounting for business combinations by, among other things, prohibiting the prospective use of pooling-of-interests accounting and requiring companies to discontinue amortizing goodwill and certain intangible assets deemed to have an indefinite useful life. Alternatively, goodwill and intangible assets deemed to have an indefinite useful life will be subject to an annual review for impairment. These Statements were adopted by the Company in the first quarter of 2002 and for all business purchase combinations consummated after June 30, 2001.

### Note 4. Revenue Recognition.

The gross billings that the Company charges its clients under its Professional Services Agreement include each worksite employee's gross wages and a service fee. The Company's service fee, which is computed as a percentage of gross wages, is intended to yield a profit to the Company and cover the cost of employment-related taxes, workers' compensation insurance coverage, and administration and field services provided by the Company to the client, including payroll administration and record keeping, as well as safety, human resources and regulatory compliance consulting services. The component of the service fee related to administration varies according to the size of the client, the amount and frequency of payroll payments and the method of delivery of such payments. The component of the service fee related to workers' compensation and employer taxes, including unemployment insurance, is based, in part, on the clients historical claims experience. All charges by the Company are invoiced along with each periodic payroll delivered to the client.

The Company reports revenue from service fees in accordance with Emerging Issues Task Force ("EITF") No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent. The Company reports as revenue, on a gross basis, the total amount billed to clients for service fees, workers' compensation and employer taxes. The Company reports revenue on a gross basis for these fees because the Company is the primary obligor and deemed to be the principal in these transactions under EITF 99-19. The Company typically bills its clients for wages paid to worksite employees in an amount equal to the amounts paid to these employees for these wages. Accordingly, such billings result in no profit to the Company and when presented on a net basis results in no revenue being recorded. The Company accounts for its revenue under the accrual method of accounting. Under the accrual method of accounting, the Company recognizes its revenues in the period in which the worksite employee performs the work.

### Note 5. Common Stock.

In February 2004 the Company effected a one-for-one hundred reverse stock split restating the number of common shares at December 31, 2003 from 1,675,736,763 to 16,757,368. All references to average number of shares outstanding and prices per share have been restated retroactively to reflect the split.

## Edgar Filing: PACEL CORP - Form 10QSB

June 30, 2004

### Note 6. Contingent Liabilities.

The Securities and Exchange Commission ("SEC") filed an action in Federal District Court asserting various violations of securities laws against the Company and its principal officer. The complaint alleges that Mr. Frank Custable "orchestrated" a "scheme" to illegally obtain stock from various companies, including the Company, through "scam Commission Form S-8 registration statements, forged stock authorization forms and at least one bogus attorney opinion letter arranged by Custable." The complaint alleges that, in connection with this alleged "scheme," the Company and its CEO, David Calkins violated Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act. The SEC asks that the Company and Calkins be permanently enjoined from future violations, ordered to pay disgorgement and civil penalties and Calkins be barred from continued service as an officer and director. As part of an ex parte proceeding, the District Court has ordered the Company and Calkins to provide an accounting of their assets and the transactions that are the subject of the complaint. Pursuant to an agreement of the parties, an accounting of the transactions at issue was provided on June 30, 2004. The Company has been served with the complaint and a scheduling order has been put into place. A response to the complaint is currently due on September 3, 2004, pursuant to an agreement of the parties. Under the scheduling order fact discovery must be completed by December 23, 2004 and expert discovery must be completed by March 29, 2005. Final dispositive pre-trial motions must be filed by May 13, 2005. A trial date has not yet been set.

During 2003, the Company began experiencing difficulties in processing unemployment claims for its North Carolina worksite employees. Upon research of the difficulties, the Company learned that its North Carolina Employment Security Commission ("ESC") account was being actively reviewed by that agency. Through discussions with the ESC, the company learned that these difficulties were the result of underpayment for unemployment taxes. The underpayments resulted from the operations of a non-acquired company, owned by the former President & CEO of the company, whose experience was imputed to the company. The company and the ESC reached an agreement of an amount and a payment schedule for these unpaid taxes. The company had previously recorded a liability for \$291,900 as assumed liabilities. The company agreed to pay this amount in installments during the third and fourth quarters of 2004.

The Company, as a member of the Phoenix Fund of North Carolina through its Asmara Services I, Inc. subsidiary, is party to an indemnity agreement providing joint and several liability for the Company to secure any outstanding liabilities should the fund become insolvent. The Phoenix Fund is a recognized insurance facility, regulated by the North Carolina Department of Insurance ("NCDOI"), through which the Company provides workers' compensation coverage to its clients located within the State of North Carolina. The Company is party to such agreement in conjunction with the other 1,200 members of the fund. The Fund, by policy, establishes reserves for all losses on a fully developed basis and is subject to quarterly and annual reporting of the status of its capitalization and operations to the NCDOI. The fund was required by the NCDOI and has issued a surety bond that would act as the primary vehicle for funding such liabilities should the fund become insolvent. The NCDOI, through provisions in the law, can waive any such assessments on behalf of the fund should the State determine that such assessment was not likely to be successful. Management believes the likelihood of any assessment is minimal due to the continued oversight of the fund by the NCDOI and the fund's establishment of sufficient reserves to cover fully developed losses.

# Edgar Filing: PACEL CORP - Form 10QSB

F-9

## PACEL CORP. AND SUBSIDIARIES Notes to the Consolidated Financial Statements June 30, 2004

### Note 7. Customer Deposit

The Company had \$145,942 in Deferred Revenue at June 30, 2004 related to \$1,100,000 paid, in advance, in December 2003 for 2004 services from two clients. In December 2003, the Company executed a letter agreement in conjunction with receipt of these funds that provides the funds be held in a separate trust account by the Company and not commingled with any other general use funds of the Company. The Company draws down the pre-payment account as needed to fund the payment of payroll, deposit taxes, benefits, fees and other costs for this single client pursuant to the agreement.

### Note 8. Cash CD-Restricted

During the second quarter of 2004, the company entered into an agreement with a national bank to develop a program that eliminates the need for multiple banks. During the credit review process, the bank required the company to secure its ACH (automated clearing house) exposure with a standby letter of credit. ACH transactions are used collect funds due from the company's clients for PEO services along with depositing funds into employee bank accounts that have elected direct deposit as a means of wage payment. The company secured this standby letter of credit with a CD (certificate of deposit) in the amount of \$600,000.

### Note 9. Retirement Plan-Director

During the first quarter of 2004, the Company entered into a Variable Flexible Premium Universal Life policy naming David E. Calkins, the Chairman of the Company, as the insured. The Company is the owner of the policy while David E. Calkins and his spouse are the beneficiaries of the policy. The insurance policy carries a face value of \$3,100,000. The account value of the insurance policy can be invested in various investment accounts as directed by the Company. The policy calls for the company to make monthly payments of \$18,333 for five years. Upon age 70, David E. Calkins will be eligible to withdraw the assets of the policy over a 15 year period. During the six months ended June 30, 2004, the Company recorded \$73,333 of expense along with the value of the assets and deferred compensation equal to \$58,175 related to the issuance of this policy.

### Note 10. Assumed Liabilities

As part of the asset purchase agreement of Asmara Inc. in April 2003, the Company assumed certain debts attributed to the President and CEO who was the sole shareholder of Asmara Inc. These debts were previously classified as Notes Payable to Officers. Upon the dismissal of the President and CEO, these debts were reclassified as Assumed Liabilities. During the six months ended June 30, 2004, the company made certain payments and reclassification and reduced the balance due on the assumed liabilities to \$550,759.

## Edgar Filing: PACEL CORP - Form 10QSB

F-10

### PACEL CORP. AND SUBSIDIARIES

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

Management's discussion and analysis of results of operations and financial condition include a discussion of liquidity and capital resources. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto.

In 2004, the Company continued its strategy for penetrating the Human Resources Outsourcing ("HRO") industry based on its evaluation of its business model and existing business initiatives completed in 2002. The Company's intention to enter this business sector was announced in September 2002 and was based on an evaluation of potential business markets that provide the potential for success. The Company provides human capital solutions through the provision of PEO services and Administrative Service Organization ("ASO") services to such clients. In 2003, the Company successfully completed the acquisition of two existing PEO organizations and continues to evaluate other potential acquisition candidates while also reviewing and implementing opportunities to support organic growth in order to secure a position as an industry leader. The Company sees this initiative in the Human Resources Outsourcing ("HRO") industry as an opportunity to tap into the small business market in the United States and intends to compliment the provision of PEO and ASO services with information technology services, business consulting services and financial services at a future time.

As part of its goal to bring the company to profitability and less reliant on equity financing for ongoing operations, the company has developed an aggressive marketing strategy as well as an investment to significantly upgrade its HRIS (Human Resource Information System) capabilities to service its current and prospective clients. The company has engaged Lincoln Consulting, LLC, a strategic marketing firm, to develop and launch an aggressive and innovative marketing and sales plan. This plan includes hiring and training the sales team as well as marketing the company's services through networks of national associations and chains. The company has also engaged Thinkware Corporation to implement its new HRIS system. This system will provide the company with "state-of-the-art" human resource data necessary to service the growing needs of small to mid-size clients as well as automate the company's internal processes. The HRIS system is targeted to be fully operational in the fourth quarter of 2004.

Through its PEO/ASO business unit, the Company markets to current and prospective clients, typically small to medium-sized businesses with between five and 1,500 employees, a broad range of products and services that provide an outsourced solution for the clients' human resources ("HR") needs. The Company's products include payroll services, benefits administration (including health, welfare and retirement plans), governmental compliance, risk management (including safety training), unemployment administration and other HR related services. The Company is currently working to establish the national vendor relationships it believes are necessary to effectively and competitively provide such services to a broad range of clients.

Six Months ended June 30, 2004 compared to the Six Months ended June 30, 2003

Revenue for the six months ended June 30, 2004 was \$1,971,154 when compared to

## Edgar Filing: PACEL CORP - Form 10QSB

revenue of \$1,147,420 for the six months ended June 30, 2003. All of the Company's revenue in the six months ended June 30, 2004 was derived from PEO operating units acquired during 2003. The difference is attributed to the comparison of six months of PEO revenue for the six months ended June 30, 2004 to three months of the PEO revenue recorded from the Benecorp Business Services acquisition and two months of the PEO revenue recorded from the Asmara acquisition during the six months ended June 30, 2003.

3

### PACEL CORP. AND SUBSIDIARIES

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

Due to the significance of the amounts included in billings to the Company's clients and its corresponding revenue recognition methods, the Company has provided the following reconciliation of billings to revenue for the six months ended June 30, 2004 and June 30, 2003.

	Six months ended June 30, 2004 (Unaudited)	Six months ended June 30, 2003 (Unaudited)
Reconciliation of billings to revenue recognized:		
Gross billings to clients	\$ 12,819,990	\$ 7,253,487
Less - Gross wages billed to clients	(10,848,836)	(6,106,690)
	-----	-----
Revenue from PEO services	1,971,154	1,146,797
Other miscellaneous revenue	-0-	623
	-----	-----
Total revenue as reported	\$ 1,971,154	\$ 1,147,420
	=====	=====

Cost of services for the six months ended June 30, 2004 increased approximately \$624,000 to \$1,537,680 when compared to cost of services of \$913,702 for the six months ended June 30, 2003 and is related directly to the delivery of services to its PEO clients. This increase is the result of having six months of PEO cost of services in the six months ended June 30, 2004 when compared to three months of PEO cost of services from the Benecorp acquisition and two months of PEO cost of services from the Asmara acquisition in 2003.

Sales, general & administrative expenses, including salaries and wages, increased to \$1,436,210 for the six months ended June 30, 2004, compared to \$1,138,255 in the corresponding period of 2003. Acquisitions completed in the second quarter of 2003, in conjunction with the Company's entry into the HRO market, accounted for the majority of the increase in 2004.

Depreciation expenses increased to \$13,496 for the six months ended June 30, 2004, compared to \$8,908 for the corresponding period of 2003. Such increase is related to the Company's acquisition of assets for its PEO business units.

Interest expense is interest paid and accrued on the Convertible Notes, unpaid payroll taxes, Notes payable, bank financing, and capital leases. Interest amounted to \$106,181 for the six months ended June 30, 2004 compared to \$91,723

## Edgar Filing: PACEL CORP - Form 10QSB

for the same period of 2003. The increase is primarily attributable to the continued use of financing for working capital.

Finance expense for the six months ended June 30, 2004 increased approximately \$1,225,000 to \$1,355,714 when compared to finance expense of \$130,750 for the six months ended June 30, 2003. The increase was the result of additional funding requirements for administrative and operational needs. The Company recorded imbedded interest in conjunction with the issuance of convertible debentures during the period assuming conversion of such debt was available on an immediate basis and has incurred fees associated with accessing its lines of credit.

4

### PACEL CORP. AND SUBSIDIARIES

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

Three Months ended June 30, 2004 compared to the Three Months ended June 30, 2003

Revenue for the quarter ended June 30, 2004 decreased approximately \$124,600 to \$1,022,233 when compared to revenue of \$1,146,837 for the quarter ended June 30, 2003. All of the Company's revenue in the quarter ended June 30, 2004 and the quarter ended June 30, 2003 was derived from PEO operating units acquired during 2003.

Even though the company experienced an increase in the number of clients it provided PEO services to during the quarter ended June 30, 2004 when compared to the quarter ended June 30, 2003, the company experienced a net loss in the total of work site employees. The company generates its revenue from services relating to work site employees. This decrease in work site employees was primarily from large construction and heavy industrial clients that terminated PEO services with the company for reasons ranging from plant and company closings to clients bringing the services typically offered in a PEO relationship in-house. The PEO industry as a whole has found it more difficult to provide the PEO services to construction and heavy industrial clients because of its inability to obtain workers compensation insurance. The company has focused its sales and marketing effort to white collar and light industrial clients where workers compensation insurance is readily and economically accessible.

Due to the significance of the amounts included in billings to the Company's clients and its corresponding revenue recognition methods, the Company has provided the following reconciliation of billings to revenue for the quarters ended June 30, 2004 and June 30, 2003.

	Three months ended June 30, 2004 (Unaudited)	Three months ended June 30, 2003 (Unaudited)	
Reconciliation of billings to revenue recognized:			
Gross billings to clients	\$ 6,641,480	\$ 7,253,487	
Less - Gross wages billed to clients	(5,619,247)	(6,106,690)	
	-----	-----	

Edgar Filing: PACEL CORP - Form 10QSB

Revenue from PEO services	1,022,233	1,146,797
Other miscellaneous revenue	-0-	40
	-----	-----
Total revenue as reported	\$ 1,022,233	\$ 1,146,837
	=====	=====

5

PACEL CORP. AND SUBSIDIARIES

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

Cost of services for the three months ended June 30, 2004 was \$778,790 when compared to cost of services of \$913,702 for the three months ended June 30, 2003 and is related directly to the delivery of services to its PEO clients. This decrease was directly related to the decrease in revenue.

Sales, general & administrative expenses, including salaries and wages, decreased to \$651,824 for the three months ended June 30, 2004, compared to \$833,667 in the corresponding period of 2003. The decrease was attributed to the consolidation of the back office operations from the acquisitions completed in the second quarter of 2003.

Depreciation expenses decreased to \$6,996 for the three months ended June 30, 2004, compared to \$7,660 for the corresponding period of 2003. This decrease was the result of asset in service becoming fully depreciated.

Interest expense is interest paid and accrued on the Convertible Notes, unpaid payroll taxes, Notes payable, bank financing, and capital leases. Interest amounted to \$65,024 for the three months ended June 30, 2004 compared to \$63,637 for the same period of 2003. The increase is primarily attributable to the continued use of financing for working capital.

Finance expense for the three months ended June 30, 2004 increased approximately \$980,000 to \$1,110,714 when compared to finance expense of \$130,750 for the six months ended June 30, 2003. The increase was the result of additional funding requirements for administrative and operational needs. The Company recorded imbedded interest in conjunction with the issuance of convertible debentures during the period assuming conversion of such debt was available on an immediate basis and has incurred fees associated with accessing its lines of credit.

6

PACEL CORP. AND SUBSIDIARIES

## Edgar Filing: PACEL CORP - Form 10QSB

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

### LIQUIDITY AND CAPITAL RESOURCES:

Cash and cash equivalents at June 30, 2004 decreased to \$243,520 from \$682,400 at December 31, 2003. Net cash used for operating activities was \$2,431,639 during the six months ended June 30, 2004 compared to \$1,040,345 in the corresponding period of 2003. The increase in the cash used in operating activities is mainly attributable to the increased operating loss for the six months ended June 30, 2004, settlement and repayment of outstanding accounts payable, accrued expenses, assumed liabilities, embedded interest, insurance deposits, and recognition of revenue previously deferred, offset by decreases in other receivables and accounts receivable to PEO clients.

Net cash used for investing activities for the six months ended June 30, 2004 was \$704,137. The cash used in investing activities is attributable to computer equipment and software purchased for the company's business information system implementation as well as an investment in a CD (certificate of deposit) to secure its payroll ACH (automated clearing house) exposure. This compares to net cash provided by investing activities for the six months ended June 30, 2003 of \$58,506. During the second quarter of 2003, the company utilized \$105,000 of cash in the acquisition of the Asmara and NCS operating units and acquired \$160,744 in the acquisition of Benecorp Business Services.

Net cash provided by financing activities in the six months ended June 30, 2004 was \$2,696,896 compared to \$1,280,134 in the corresponding period ended June 30, 2003. The cash provided during both periods is directly related to the Company's execution and utilization of three equity-based lines of credit.

### PACEL CORP. AND SUBSIDIARIES

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



## Edgar Filing: PACEL CORP - Form 10QSB

In August 2003, the Company entered into an equity line of credit for \$10,000,000 from Compass Capital Inc., Kentan Ltd, and T&B Associates, Inc. at a discount rate of up to 50%. The Company can draw up to \$500,000 per month. The line is being used to fund acquisitions and shortfalls in working capital. During the six months ended June 30, 2004, the Company drew down \$2,680,898 and issued 319,113,632 shares of common stock in conjunction with this equity line. All of the funds received in 2004 were drawn from the Company's agreement with Compass Capital, Inc and T&B Associates, Inc.

In the six months ended June 30, 2004, the company utilized its 3A10 filing to issue 320,131,115 shares of its common stock. Proceeds from this issuance resulted in \$2,770,898 in cash of which \$90,000 was used to pay accrued interest.

In April 2004, Pacel entered into a Letter of Intent to Purchase RossarHR, LLC. The purchase will add in excess of \$2 million in revenue to the Company on an annualized basis. The purchase does not contemplate any cash paid to the seller at closing. The Company will assume approximately \$300,000 in debt of the acquired company with the majority being a term note at 6% interest payable in monthly installment of approximately \$2,400 over 9.25 years. It is anticipated the purchase will be finalized by the end of September 2004.

The Company's cash requirements for funding its administrative and operating needs continue to greatly exceed its cash flows generated from operations. Such shortfalls and other capital needs continue to be satisfied through equity financing and convertible notes payable, until additional funds can be generated through acquisitions and organic business growth. The liabilities of the Company consist of over-extended accounts payable, payroll taxes, and interest expense. As part of its goal to bring the Company to profitability and less reliant on equity financing for ongoing operations, the Company has developed an aggressive marketing strategy as well as an investment to significantly upgrade its HRIS (Human Resource Information System) capabilities to service its current and prospective clients. The Company has engaged Lincoln Consulting, LLC, a strategic marketing firm, to develop and launch an aggressive and innovative marketing and sales plan. This plan includes hiring and training the sales team as well as marketing the Company's services through networks of national associations and chains. The Company has also engaged Thinkware Corporation to implement its new HRIS system. This system will provide the company with "state-of-the-art" human resource data necessary to service the growing needs of small to mid-size clients as well as automate the Company's internal processes. The HRIS system is targeted to be fully operational in the fourth quarter of 2004. The Company relies on equity financing to fund its ongoing operations and investing activities. The Company expects to continue its investing activities, including expenditures for acquisitions, sales and marketing initiatives, HRIS (Human Resource Information System), and administrative support. The loss of its current equity financing would seriously hinder the Company's ability to execute its business strategy and impair its ability to continue as a going concern.

### PACEL CORP. AND SUBSIDIARIES

#### Forward Looking Statements

The Company is making this statement in order to satisfy the "safe harbor" provisions contained in the Private Securities Litigation Reform Act of 1995.

This Form 10-QSB includes forward-looking statements relating to the business of

## Edgar Filing: PACEL CORP - Form 10QSB

the Company. Forward-looking statements contained herein or in other statements made by the Company are made based on management's expectations and beliefs concerning future events impacting the Company and are subject to uncertainties and factors relating to the Company's operations and business environment, all of which are difficult to predict and many of which are beyond the control of the Company, that could cause actual results of the Company to differ materially from those matters expressed in or implied by forward-looking statements. The Company believes that the following factors, among others, could affect its future performance and cause actual results of the Company to differ materially from those expressed in or implied by forward-looking statements made by or on behalf of the Company: (a) the effect of technological changes; (b) increases in or unexpected losses; (c) increased competition; (d) fluctuations in the costs to operate the business; (e) uninsurable risks; and (f) general economic conditions.

### Item 3. CONTROLS AND PROCEDURES.

As of June 30, 2004, an evaluation was performed under the supervision and with the participation of the Company's management, including the Principal Executive Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the Principal Executive Officer and the Principal Accounting Officer, concluded that the Company's disclosure controls and procedures were effective as of June 30, 2004. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to June 30, 2004.

## PACEL CORP. AND SUBSIDIARIES

### PART II. OTHER INFORMATION

#### Item 1. LEGAL PROCEEDINGS

The Securities and Exchange Commission ("SEC") filed an action in Federal District Court asserting various violations of securities laws against the Company and its principal officer. The complaint alleges that Mr. Frank Custable "orchestrated" a "scheme" to illegally obtain stock from various companies, including the Company, through "scam Commission Form S-8 registration statements, forged stock authorization forms and at least one bogus attorney opinion letter arranged by Custable." The complaint alleges that, in connection with this alleged "scheme," the Company and its CEO, David Calkins violated Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act. The SEC asks that the Company and Calkins be permanently enjoined from future violations, ordered to pay disgorgement and civil penalties and Calkins be barred from continued service as an officer and director. As part of an ex parte proceeding, the District Court has ordered the Company and Calkins to provide an accounting of their assets and the transactions that are the subject of the complaint. Pursuant to an agreement of the parties, an accounting

## Edgar Filing: PACEL CORP - Form 10QSB

of the transactions at issue was provided on June 30, 2004. The Company has been served with the complaint and a scheduling order has been put into place. A response to the complaint is currently due on September 3, 2004, pursuant to an agreement of the parties. Under the scheduling order fact discovery must be completed by December 23, 2004 and expert discovery must be completed by March 29, 2005. Final dispositive pre-trial motions must be filed by May 13, 2005. A trial date has not yet been set.

The Board of Directors dismissed the President and CEO for cause, the grounds of which included, but are not limited to, unauthorized prepayments and charges from corporate funds directed by him against acquisition debt held by him. The Board of Directors is evaluating possible remedies, if any, against the decision makers for the unauthorized prepayments.

The Company is a defendant in various lawsuits, mainly with previous vendors of the Company still owed monies. The Company continues to settle such claims and hired a law firm to handle such negotiations. All claims are recorded as liabilities on the balance sheet of the Company and the Company believes such recorded reserves to be adequate for the settlement of the claims.

### Item 2. Changes in Securities

In February 2004 the Company effected a one-for-one hundred reverse stock split restating the number of common shares at December 31, 2003 from 1,675,736,763 to 16,757,368. All references to average number of shares outstanding and prices per share have been restated retroactively to reflect the split.

#### Option Grants

None

#### Issuances of Stock for Services or in Satisfaction of Obligations

None.

### Item 3. Defaults Upon Senior Securities

None

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

None.

## PACEL CORP. AND SUBSIDIARIES

### Item 5. Other Information

None

### Item 6. Exhibits and Reports

None

[Balance of this page intentionally left blank]

11

Item 7. Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, registrant has duly caused this report to be signed in its behalf by the undersigned thereunto duly authorized.

Pacel Corp.

Edgar Filing: PACEL CORP - Form 10QSB

BY: /s/ Gary Musselman

-----

Gary Musselman, President, Chief Executive Officer, and Chief Financial Officer

DATED: August 19, 2004