

PACEL CORP
Form 10QSB
November 12, 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 September 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)

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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:

As of November 12, 2004, there were 1,204,667,610 shares of the Registrant's common stock outstanding.

PACEL CORP. AND SUBSIDIARIES

FINANCIAL INFORMATION (unaudited)

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PACEL CORP. AND SUBSIDIARIES

Consolidated Balance Sheets

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September 30, December 31,

2004 2003 _____

(Unaudited) (Audited)

ASSETS

Current assets:

| | | |
|--|----------------|----------------|
| Cash | \$ 230,821 | \$ 682,400 |
| Cash CD-Restricted | 907,727 | -0- |
| Trust account – client deposits and advance payments | 27,513 | 1,100,000 |
| Accounts receivable | 8,705 | 70,384 |
| Stock subscription receivable | -0- | 125,000 |
| Prepaid expenses | 165,578 | 44,326 |
| Workers compensation insurance deposits | <u>101,016</u> | <u>132,851</u> |

| | | |
|----------------------|------------------|------------------|
| - | | |
| Total current assets | <u>1,441,360</u> | <u>2,154,961</u> |

Property and equipment, net of accumulated depreciation of

| | | |
|--------------------------------------|----------------|---------------|
| \$35,946 and \$153,578, respectively | <u>247,652</u> | <u>97,355</u> |
|--------------------------------------|----------------|---------------|

Other assets:

| | | |
|--------------------------|--------------|--------------|
| Other receivables | -0- | 7,902 |
| Retirement Plan-Director | 100,408 | -0- |
| Goodwill | 1,075,432 | 1,075,432 |
| Security deposits | <u>8,122</u> | <u>9,366</u> |

| | | |
|--------------------|------------------|------------------|
| Total other assets | <u>1,183,962</u> | <u>1,092,700</u> |
|--------------------|------------------|------------------|

| | | |
|---------------------|----------------------------|----------------------------|
| Total assets | <u>\$ 2,872,974</u> | <u>\$ 3,345,016</u> |
|---------------------|----------------------------|----------------------------|

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-

See accompanying notes to the consolidated financial statements.

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PACEL CORP. AND SUBSIDIARIES
Consolidated Balance Sheets

September 30, December 31,

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2004 2003____

(Unaudited) (Audited)

-

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current liabilities:

| | | |
|---|---------------|---------------|
| Accounts payable | \$ 913,968 | \$ 1,119,543 |
| Payroll and payroll related liabilities | 2,077,905 | 2,413,244 |
| Accrued expenses | 577,626 | 559,229 |
| Accrued expenses – officers | 33,699 | 251,583 |
| Assumed Liabilities | 493,133 | 1,116,381 |
| Client deposits and advance payments | 27,513 | 1,100,000 |
| Notes payable | 500,000 | 505,218 |
| Convertible Notes Payable | 1,140,930 | -0- |
| Notes payable – bank | 26,880 | 33,900 |
| Capital leases | -0- | 13,608 |
| Income taxes payable | <u>-0-</u> | <u>2,532</u> |
| Total current liabilities | 5,791,654 | 7,115,238 |

Long-term liabilities:

| | | |
|--|----------------|---------------|
| Deferred Compensation-Director Payable | <u>100,408</u> | <u>-0-</u> |
| Total liabilities | 5,892,062 | 7,115,238 |

Stockholders' equity (deficit):

Preferred stock, no par value, no liquidation value,

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| | | |
|--|----------------------------|----------------------------|
| 5,000,000 shares authorized, 1,000,000 shares | | |
| of 1997 Class A convertible preferred stock | 11,320 | 11,320 |
| Common stock, no par value, 2,000,000,000 shares | | |
| authorized, 56,000,857 and 167,574 | | |
| shares issued and outstanding in 2004 and 2003 | | |
| respectively. | 21,958,408 | 17,500,377 |
| Cumulative currency translation adjustment | (18,720) | (18,720) |
| Accumulated deficit | <u>(24,970,096)</u> | <u>(21,263,199)</u> |
| Total stockholders' (deficit) | <u>(3,019,088)</u> | <u>(3,770,222)</u> |
| Total liabilities and stockholders' deficit | <u>\$ 2,872,974</u> | <u>\$ 3,345,016</u> |

See accompanying notes to the consolidated financial statements.

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PACEL CORP. AND SUBSIDIARIES

Consolidated Statements of Operations

(Unaudited)

Nine months ended

September 30,

Three months ended

September 30,

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| | <u>2004</u> | <u>2003</u> | <u>2004</u> | <u>2003</u> |
|-------------------------------------|------------------------------|------------------------------|------------------------------|----------------------------|
| Revenue | \$ 2,894,780 | \$ 2,507,291 | \$ 923,626 | \$ 1,369,370 |
| Cost of services | <u>2,354,047</u> | <u>1,898,953</u> | <u>816,317</u> | <u>984,874</u> |
| Gross profit | 540,733 | 608,338 | 107,309 | 384,496 |
| Operating costs and expenses: | | | | |
| General and administrative | 2,026,502 | 1,910,958 | 761,989 | 905,441 |
| Sales & Marketing | 330,778 | 252,585 | 159,130 | 119,336 |
| Depreciation and amortization | <u>19,244</u> | <u>15,722</u> | <u>5,748</u> | <u>6,814</u> |
| Total operating expenses | 2,376,524 | 2,179,265 | 926,867 | 1,031,591 |
| Operating loss | (1,835,791) | (1,570,927) | (819,558) | (647,095) |
| Interest expense | 153,044 | 125,015 | 46,864 | 32,852 |
| Financing costs | <u>1,718,063</u> | <u>393,818</u> | <u>362,349</u> | <u>262,978</u> |
| Total interest and finance expenses | 1,871,107 | 518,833 | 409,213 | 295,830 |
| Net loss | <u>\$ (3,706,898)</u> | <u>\$ (2,089,760)</u> | <u>\$ (1,228,771)</u> | <u>\$ (942,925)</u> |

Net loss per common and common equivalent share:

| | | | | |
|---------|-----------|-------------|-----------|------------|
| Basic | \$ (0.72) | \$ (107.93) | \$ (0.09) | \$ (23.52) |
| Diluted | \$ (0.72) | \$ (107.93) | \$ (0.09) | \$ (23.52) |

Weighted average shares outstanding:

| | | | | |
|---------|-----------|--------|------------|--------|
| Basic | 5,113,002 | 19,362 | 13,754,242 | 40,094 |
| Diluted | 5,113,002 | 19,362 | 13,754,242 | 40,094 |

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PACEL CORP. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

Nine months ended

September 30,

2004

2003 ____

Cash flows from operating activities:

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| | | | |
|---|----------------|------------------|----------------|
| Net loss | | \$ (3,706,898) | \$ (2,089,760) |
| Adjustments to reconcile net loss to net cash | | | |
| provided by (used in) operating activities: | | | |
| Depreciation | 19,244 | 15,722 | |
| Other non-cash items | 1,908,063 | 800,694 | |
| Increase (decrease) in cash from changes in: | | | |
| Accounts receivable | 61,679 | 4,643 | |
| Other receivables | 82,902 | (55,395) | |
| Insurance deposits | 31,835 | 28,006 | |
| Prepaid expenses | (121,251) | 7,133 | |
| Security deposits | 1,243 | (600) | |
| Accounts payable | (205,574) | (376,992) | |
| Accrued expenses | 18,398 | 62,717 | |
| Accrued expenses-Officers | (217,885) | -0- | |
| Payroll and payroll related liabilities | (335,339) | 611,785 | |
| Deferred Revenue | -0- | (881,937) | |
| Assumed liabilities | (623,248) | (36,023) | |
| Income taxes payable | <u>(2,532)</u> | <u>-0-</u> | |
| Net cash (used in) operating activities | (3,089,363) | (1,910,007) | |
| Cash flows from investing activities: | | | |
| Net purchases of property and equipment | (169,542) | (8,942) | |
| Notes receivable | -0- | 50,000 | |
| Cash CD-Restricted | (907,727) | -0- | |
| Cash acquired in acquisitions | -0- | 160,744 | |
| Cash used for acquisitions | <u>-0-</u> | <u>(105,000)</u> | |
| Net cash (used in) investing activities | (1,077,269) | 96,802 | |

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Cash flows from financing activities:

| | | |
|--|--------------------------|--------------------------|
| Repayments of notes payable | (95,218) | (130,534) |
| Issuance of notes payable | 90,000 | -0- |
| Issuance of convertible notes payable | 3,740,898 | 2,119,045 |
| Repayments of lines of credit | (7,018) | (2,690) |
| Repayments of capital lease | <u>(13,609)</u> | <u>-0-</u> |
| Net cash provided by financing activities | <u>3,715,053</u> | <u>1,985,821</u> |
| Net increase (decrease) in cash and cash equivalents | (451,579) | 172,616 |
| Cash and cash equivalents, beginning of period | <u>682,400</u> | <u>8,379</u> |
| Cash and cash equivalents, end of period | <u>\$ 230,821</u> | <u>\$ 180,995</u> |

See accompanying notes to the consolidated financial statements.

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PACEL CORP. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

Nine months ended

September 30,

2004

2003

Supplemental disclosure of cash flow information:

| | | |
|-------------------------------|-------------------------|-------------------------|
| Cash paid for interest | <u>\$ 42,348</u> | <u>\$ 14,126</u> |
|-------------------------------|-------------------------|-------------------------|

See accompanying notes to the consolidated financial statements.

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PACEL CORP. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

September 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.

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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.

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.

The Company made payments to David Calkins for accrued payroll and loans. The balance due to Mr. Calkins was \$33,699 and \$251,583 at Sep

In May 2004, Kaye Calkins, Director, and wife of David Calkins formed Piedmont HR Inc. The purpose of Piedmont HR Inc is to provide Hum

In September 2004, The Company entered into a ten year employment contracts with Gary A. Mussleman. Compensation will include an annual

In September 2004, The Company entered into a ten year employment contracts with David E. Calkins. Compensation will include an annual ba

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PACEL CORP. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

September 30, 2004

Note 3. Accounting for Business Combinations.

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In July 2001, the Financial Accounting Standards Board (the "FASB") issued 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 and September 2004, the Company effected a one-for-one hundred reverse stock split restating the number of common shares a

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PACEL CORP. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

September 30, 2004

Note 6. Acquisitions

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In September 2004, The Company, through its subsidiary The Resourcing Solutions Group, Inc, entered into a definitive asset purchase agreement of RossarHR, LLC effective January 1, 2005. As part of this agreement, the company will receive approximately \$15,000 in office equipment along with all customer contracts. The purchase does not contemplate any cash paid to the seller at closing, but calls for a Promissory Note of \$272,000 to be paid in equal monthly installments over ten years starting after the effective date. The two companies also have entered into a Management Agreement whereas The Resourcing Solutions Group, Inc will provide management resources up to the effective date.

Note 7. 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. Pursuant to an agreement of the parties, the response to the complaint has been postponed to a date to be agreed upon. 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 Company, as a member of the Phoenix Fund of North Carolina through its Asmara Services II, Inc. and Asmara Services III, Inc. subsidiaries, 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.

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PACEL CORP. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

September 30, 2004

Note 8. Customer Deposit

The Company had \$27,513 in Deferred Revenue on September 30, 2004. The company received \$1,100,000 in December 2003 for 2004 service

Note 9. 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

During the second and third quarter of 2004, as part of the renewal process for one of its insurance carriers and two state PEO (Professional Emp

Note 10. 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 Cha

Note 11. 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. The balance at the nine months ended September 30, 2004 was \$493,133.

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

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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.

Nine Months ended September 30, 2004 compared to the Nine Months ended September 30, 2003

Revenue for the Nine months ended September 30, 2004 was \$2,894,780 compared to revenue of \$2,507,291 for the nine months ended September 30, 2003. All of the Company's revenue in the nine months ended September 30, 2004 was derived from PEO operating units acquired during 2003. The difference is attributed to the comparison of nine months of PEO revenue for the nine months ended September 30, 2004 to six months of the PEO revenue recorded from the Benecorp Business Services acquisition and five months of the PEO revenue recorded from the Asmara acquisition during the nine months ended September 30, 2003. The company generates its revenue from services relating to work site employees. During 2004, the company has experienced a decrease in the number of work site employees it provided PEO services. These losses were primarily in blue-collar industries. The company has been heavily marketing its services and Human Resources Information Systems to national chains, white-collar, and light industrial clients. The company expects white-collar and national chain clients to replace its expected loss in blue-collar clients.

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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 nine months ended September 30, 2004 and September 30, 2003.

| | Nine months ended September 30, <u>2004</u> | Nine months ended September 30, 2003 |
|---|---|--|
| | (Unaudited) | (Unaudited) |
| Reconciliation of billings to revenue recognized: | | |
| Gross billings to clients | \$ 19,110,946 | \$ 16,098,762 |
| Less – Gross wages billed to clients | <u>(16,216,166)</u> | <u>(13,592,194)</u> |
| Revenue from PEO services | 2,894,780 | 2,506,568 |
| Other miscellaneous revenue | <u>-0-</u> | <u>723</u> |
| Total revenue as reported | <u>\$ 2,894,780</u> | <u>\$ 2,507,291</u> |

Cost of services for the nine months ended September 30, 2004 increased approximately \$455,000 to \$2,354,047 compared to cost of services of \$1,898,953 for the nine months ended September 30, 2003 and is related directly to the delivery of services to its PEO clients. This increase is the result of having nine months of PEO cost of services in the nine months ended September 30, 2004 when compared to six months of PEO cost of services from the Benecorp acquisition and five months of PEO cost of services from the Asmara acquisition in 2003.

General & administrative expenses, including salaries and wages, increased to \$2,026,502 for the nine months ended September 30, 2004, compared to \$1,910,958 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.

Sales and Marketing expenses increased to \$330,778 for the nine months ended September 30, 2004, compared to \$252,585 in the corresponding period of 2003. The sales approach in prior years was to employ salespeople to actively find potential PEO clients primarily in blue-collar industries. During the second and third quarter of 2004, the company redesigned all marketing literature and hired a new sales force. The

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company is also in the process of updating its website and implementing a new Human Resource Information System to target white-collar and light industrial clients where the company believes it can be successful. This complete restructuring of the company's sales and marketing function will be completed in the fourth quarter of 2004 and is expected to realize an increase in work site employees beginning in the first quarter of 2005.

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PACEL CORP. AND SUBSIDIARIES

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

Depreciation expenses increased to \$19,244 for the nine months ended September 30, 2004, compared to \$15,722 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 expense amounted to \$153,044 for the nine months ended September 30, 2004 compared to \$125,015 for the same period of 2003. The increase is primarily attributable to the continued use of financing for working capital.

Finance expense for the nine months ended September 30, 2004 increased approximately \$1,324,000 to \$1,718,063 compared to finance expense of \$393,818 for the nine months ended September 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.

PACEL CORP. AND SUBSIDIARIES

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

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

Revenue for the quarter ended September 30, 2004 decreased approximately \$445,700 to \$923,626 compared to revenue of \$1,369,370 for the quarter ended September 30, 2003. All of the Company's revenue in the quarter ended September 30, 2004 and the quarter ended September 30, 2003 was derived from PEO operating units acquired during 2003.

The company experienced a decrease in the number of work site employees it provided PEO services to during the quarter ended September 30, 2004 compared to the quarter ended September 30, 2003. 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 September 30, 2004 and September 30, 2003.

| | Three months ended September 30, <u>2004</u> | Three months ended September 30, 2003 |
|---|--|---|
| | (Unaudited) | (Unaudited) |
| Reconciliation of billings to revenue recognized: | | |
| Gross billings to clients | \$ 6,290,956 | \$ 8,654,774 |
| Less – Gross wages billed to clients | <u>(5,367,330)</u> | <u>(7,285,504)</u> |

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| | | |
|-----------------------------|------------|------------|
| Revenue from PEO services | 923,626 | 1,369,270 |
| Other miscellaneous revenue | <u>-0-</u> | <u>100</u> |

Total revenue as reported \$ 923,626 \$ 1,369,370

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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 September 30, 2004 was \$816,317 compared to cost of services of \$984,874 for the three months ended September 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.

General & administrative expenses, including salaries and wages, decreased to \$761,989 for the three months ended September 30, 2004, compared to \$905,441 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.

Sales and marketing expenses increased to \$159,130 for the three months ended September 30, 2004, compared to \$119,336 in the corresponding period of 2003. The increase was attributed to the company's continued transformation of its sales and marketing function that began in the second quarter of 2004.

Depreciation expenses decreased to \$5,748 for the three months ended September 30, 2004, compared to \$6,814 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 expense amounted to \$46,864 for the three months ended September 30, 2004 compared to \$32,852 for the same period of 2003. The increase is primarily attributable to the continued use of financing for working capital.

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Finance expense for the three months ended September 30, 2004 increased approximately \$99,000 to \$362,349 when compared to finance expense of \$262,978 for the three months ended September 30, 2003. The increase was the result of increased 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.

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PACEL CORP. AND SUBSIDIARIES

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

LIQUIDITY AND CAPITAL RESOURCES:

Cash and cash equivalents at September 30, 2004 decreased to \$230,821 from \$682,400 at December 31, 2003. Net cash used for operating activities was \$3,089,363 during the nine months ended September 30, 2004 compared to \$1,910,007 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 nine months ended September 30, 2004, settlement and repayment of outstanding accounts payable, accrued expenses, assumed liabilities, embedded interest, and recognition of revenue previously deferred, offset by decreases in other receivables, accounts receivable to PEO clients, and insurance deposits.

Net cash used for investing activities for the nine months ended September 30, 2004 was \$1,077,269. 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 four CD's (certificate of deposits). These CD's were used to secure Letters of Credit for its payroll ACH (automated clearing house) exposure, one of the company's workers compensation insurance policy, and two state PEO licenses. This compares to net cash provided by investing activities for the nine months ended September 30, 2003 of \$96,802. 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 nine months ended September 30, 2004 was \$3,715,053 compared to \$1,985,821 in the corresponding period ended September 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.

In August 2003, the Company entered into an equity line of credit for \$10,000,000 from Compass Capital Inc., Kentan Ltd, Reef Holding Ltd, and

In September 2004, The Company, through its subsidiary The Resourcing Solutions Group, Inc, entered into a definitive asset purchase agreement of RossarHR, LLC effective January 1, 2005. The purchase will add approximately \$500,000 in revenue on an annualized basis. The purchase does not contemplate any cash paid to the seller at closing, but call for a Promissory Note of \$272,000 to be paid in equal monthly installments over ten years starting after the effective date. The two companies also have entered into a Management Agreement whereas The

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Resourcing Solutions Group, Inc will provide management resources up to the effective date.

In September 2004, The Company entered into a ten year employment contracts with Gary A. Mussleman. Compensation will include an annual base salary of \$168,000 and an incentive bonus plan based on the EBITDA (earnings before interest, tax, depreciation and amortization). The agreement also includes severance payments upon termination of employment. Mr. Musselman will hold the title of President and Chief Executive Officer.

In September 2004, The Company entered into a ten year employment contracts with David E. Calkins. Compensation will include an annual base salary of \$300,000, an incentive bonus plan based on the EBITDA (earnings before interest, tax, depreciation and amortization), and the funding of a Variable Flexible Premium Universal Life Policy. The agreement also includes severance payments upon termination of employment. Mr. Calkins will hold the title of Chairman of the Board of Directors.

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.

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PACEL CORP. AND SUBSIDIARIES

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

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.

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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 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 September 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 September 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 September 30, 2004.

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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 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. Pursuant to an agreement of the parties, the response to the complaint has been postponed to a date to be agreed upon. 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.

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Item 2. Changes in Securities and Small Business Issuer Purchases of Equity Securities

In September 2004, the Company effected a one-for-one hundred reverse stock split restating the number of common shares at December 31, 2004.

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PACEL CORP. AND SUBSIDIARIES

Item 6. Exhibits and Reports

(a) The exhibits required to be filed herewith by Item 601 of Regulation S-B, as described in the following index of exhibits, are incorporated herein by reference, as follows:

Exhibit No. Description

31.1 * Section 302 Certification by Chief Executive Officer and Chief Financial Officer.

32.1 * Section 906 Certification by Chief Executive Officer.

(b) The following reports were filed during the period covered by this Form 10-QSB:

September 17, 2004 Item 8.01. Other Events

September 29, 2004 Item 8.01. Other Events

Item 1. Legal Proceedings

Item 9.01. Financial Statements and Exhibits

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.

BY: /s/ Gary Musselman

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

DATED: November 12, 2004

