PACEL CORP
Form 10QSB
November 20, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

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

For the quarterly period ended September 30, 2001

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)

8870 RIXLEW LANE, SUITE 201, MANASSAS, VIRGINIA	20109-3795
(Address of principal executive offices)	(ZIP Code)

Registrant's telephone number, including area code: (703) 257-4759

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 [X] No [ ]

Transitional Small Business Disclosure Format (check one)

Yes [ ] No [X]

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

As of September 30, 2001, there were 120,670,772 shares of the Registrant's common stock outstanding.

PACEL CORP. AND SUBSIDIARIES

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PACEL CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS

	UNAUDITED September 30, 2001	AUDITED December 31, 2000

Current assets:		
Cash and cash equivalents	$ 175,247	$ 36,356
Accounts receivable, net of allowance for doubtful accounts of $7,647 and $5,155 respectively	356,055	9,883
Inventory	64,347	17,213
Other receivables	55,249	64,760
Prepaid expenses	19,038	2,469
Total current assets	669,936	130,681
Property and equipment, net of accumulated depreciation of $84,489 and $65,531 respectively	139,290	141,882
Non-current assets:		
Note receivable	71,000	71,000
Goodwill	273,701	8,106
Security deposits	11,880	9,089
Total non-current assets	356,581	88,195
Total assets	$ 1,165,807	$ 360,758

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

Current liabilities:		
Accounts payable	$ 1,296,145	$ 491,926
Accrued expense	89,358	73,071
Loans payable officers-Stockholders	206,325	62,741
Notes payable convertible debenture	1,331,440	531,389
Notes payable bank	50,000	50,000
Total current liabilities	2,973,268	1,209,127
Long term liabilities:		
Equipment leases	98,582	--
Total long term liabilities	98,582	--
Total liabilities	3,071,850	1,209,127
Minority interest		
Commitments:		
Stockholders' equity (deficit)		
Preferred stock, no par value, no liquidation value, 5,000,000 shares authorized, issued 1,000,000 shares 1997 class A convertible preferred stock	11,320	11,320
Common stock - no par value, 150,000,000 shares authorized in 2001 and 2000, respectively. 120,670,772 and 30,570,560 shares outstanding in 2001 and 2000, respectively	5,984,325	5,155,914
Cumulative currency translation adjustment	(15,738)	(10,833)
Deficit	(7,787,368)	(6,004,770)
Total stockholders' equity (deficit)	(1,807,461)	(848,369)

Total liabilities and stockholders' equity	$ 1,165,807	$ 360,758
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See accompanying notes to consolidated financial statements

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PACEL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	NINE MONTHS ENDED SEPTEMBER 30, 2001	NINE MONTHS ENDED SEPTEMBER 30, 2000	THREE MONTHS ENDED SEPTEMBER 30, 2001	THREE MONT ENDED SEPTEMBER 30, 2000
Sales	$ 984,638	$ 184,363	$ 555,550	$ 68,4
Direct Cost of Goods Sold	704,311	56,667	405,204	52,4
Gross Profit	280,327	127,696	150,346	15,9
Operating costs and expenses:				
Research and development	306,806	926,382	87,521	52,8
Depreciation & Amortization	14,364	21,460	1,323	7,0
Interest expense	53,333	52,772	27,699	11,1
Sales and Marketing	104,425	390,285	36,334	171,7
Financing Expenses	276,273	--	195,173	--
General and Administrative	1,310,520	1,250,394	329,252	755,2
Total operating costs and expenses	2,065,721	2,641,293	677,302	997,9
Other Income	2,796	4,180	932	(2
Net (loss)	$ (1,782,598)	$ (2,509,417)	$ (526,024)	$ (982,3

Net (loss) per common share

Basic	(0.04)	(0.12)	(0.01)	(0.
Diluted	(0.04)	(0.12)	(0.01)	(0.
Weighted Average shares outstanding				
Basic	44,449,205	21,016,674	44,449,205	22,378,6
Diluted	44,449,205	21,016,674	44,449,205	22,378,6

See accompanying notes to consolidated financial statements

PACEL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30

	2001	2000
Cash flows from operating activities:		
Net (loss)	$(1,782,598)	$(2,509,417)
Adjustments to reconcile net (loss) to net cash (used in) provided by operating activities:		
Depreciation	19,779	21,460
Provision for Bad Debts	2,492	598
Other non cash items	156,705	57,791
Increase (Decrease) in Cash from changes in:		
Accounts receivable	(348,664)	3,997
Other receivables	9,511	(22,942)
Inventory	(47,134)	(14,406)
Other assets	0	0
Security deposits	(2,791)	15
Good will	(265,595)	1,623
Prepaid expenses	(16,569)	11,545
Accounts payable	804,219	(48,713)
Accrued expense	16,287	(68,454)
Loans Payable Officers-Stockholders	143,584	(10,000)
Net cash (used in) operating activities	(1,045,179)	(2,576,903)

Cash flows from investing activities:		
Purchase of property and equipment	(13,856)	(122,683)
Net cash used in investing activities	(13,856)	(122,683)
Cash flows from financing activities:		
Notes payable convertible debenture	746,718	404,132
Proceeds from long term leases	98,582	0
Proceeds from sale of common stock	357,531	2,296,913
Net cash provided by financing activities	1,295,412	2,701,045
Effect of exchange rates on cash	(4,905)	(6,162)
Net increase (Decrease) in cash and cash equivalents	138,891	(4,703)
Cash and cash equivalents at beginning of year	36,356	95,631
Cash and cash equivalents at end of period	$ 175,247	$ 90,928
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	4,872	3,128

See accompanying notes to consolidated financial statements

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PACEL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED
SEPTEMBER 30, 2001

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. 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.

These interim statements should be read in conjunction with the audited December 31, 2000 consolidated financial statements and related notes included in the Company's year ended certified financial statements. The results of operations for the nine months are not necessarily indicative of the operating results for the year. The Company presumes that users of the interim financial information herein have read or have access to the audited financial statements for the preceding fiscal year 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 for the full year.

2. ACQUISITION OF ADVANTAGE SYSTEMS INC. (ASI)

In September 2001, Pacel Acquisition Corp. a wholly owned subsidiary completed its acquisition of Advantage Systems, Inc. a computer manufacture, for $70,000 and the assume of $238,727 in debt. Pacel Acquisition Corp. has accounted for the acquisition under the purchase method of accounting in accordance with generally accepted accounting principles. Pacel has recorded in its consolidated financial statements all of the assets and liabilities of Advantage. Good will of $197,218 has been recorded on Pacel's books. On September 14, 2001 Pacel Acquisition was merge into Pacel Corp. Pacel has secured a $1,000,000 convertible note to purchase this company.

FORWARD-LOOKING STATEMENTS

When used in this document and in our filings with the Securities and Exchange Commission, in our press releases or other public or shareholder communications, and in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project" or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are subject to certain risks and uncertainties, which could cause our actual results to differ materially from our historical results and those we presently anticipate or project. You should not place undue reliance on any forward-looking statements, which speak only as of the date made. Various factors could affect our financial performance and could cause our actual results for future periods to differ materially from any opinions or statements we express with respect to future periods in any current statement. These factors include, but are not limited to, the following: increases in our operating expenses outpacing our revenues; our inability to expand our sales and distribution channels; the failure of strategic relationships to implement and promote our software products; the failure of third parties to develop software components necessary for the integration of applications using our software; and the use of our intellectual property by others.

We do not undertake--and we specifically decline any obligation--to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

GENERAL BUSINESS

PACEL's mission is to provide consumers and businesses with a full suite of products and services that provide secure connectivity to and from the Internet, including e-commerce transactions and personnel and company data security. To that end, PACEL, and its subsidiaries, Fairfax Communications and E-Business Store.Com, have been developing products and methods that meet that need for both families and companies. The ChildWatch software suite of programs puts the controls for family computer usage, including internet filtering, access controls and community support for finding missing and abducted children

in the hands of the parents and is readily available at Zany Brany and Electronic Boutique stores nationally. "e-Centurion" our latest technology advancement (patent pending) software product will provide complete file and data security. This new software is designed to guard both the Inner Door (full protection on your PC from existing and new viruses), i.e., the Love Bug, and someone trying to penetrate your PC and by-pass your password. As well as, the Outer Door (full intruder protection from Internet data collection devices and programs or hackers). Our current goal is to utilize and extend these technologies in the production of derivative products to provide secure Internet connectivity and enhanced desktop security for customers in the home and business marketplaces.

RESULTS OF OPERATIONS

The following summarizes the basic results of operations for the periods indicated in the Consolidated Statement of Operations.

NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2000.

For the nine months ended September 30, 2001, sales were $984,638 compared to $184,363 for the nine months ended September 30, 2000 an increase of $800,275 or 434%. The increase in revenues is attributed to the sales generated from existing NATO contracts of Fairfax Communication Limited (FCL) and Advantage Systems existing customer base. Sales for the month of September 2001 for Advantage Systems were $236,138. E-Business Store continues to increase their sales in consulting and web development. With acquisition of Advantage Systems we are refocusing our efforts, to the distribution of hardware and consulting services through (FCL) NATO contracts. We will continue to focus our efforts on the marketing of Child Watch software and e-Centurion anti-virus software as adequate funding becomes available. We believe that marketing delays have prevented Child Watch and e-Centurion from penetrating their respective markets. Accordingly only limited revenues from the Child Watch and e-Centurion software have been realized to date. The Company's' marketing delays stem from the inability to obtain adequate financing through the end of the third quarter. We do not expect to see any significant revenue from these products until adequate financing is available to market these products.

For the nine months ended September 30, 2001, direct cost of goods sold were $704,311 compared to $56,667 for the nine months ended September 30, 2000 an increase of $647,644. The increase in direct cost of goods sold is directly attributed to the sales generated from the NATO contracts and Advantage Systems discussed above. FCL is selling computer hardware items through Dell and Gateway. The mark up for computer hardware is typically greater in Great Britain than in the United States. Advantage costs of goods sold are higher due to the lower margins on hardware in the United States.

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Research and development expenses consist principally of salaries for software developers, outside consulting, and related facilities costs for software development. Research and Development expenses for the nine months ended September 30, 2001, were $306,806 compared to $926,382 for the nine months ended September 30, 2000 a decrease of $619,576. The decrease is directly attributable to being in the final phase of ChildWatch and e-Centurion software development. We believe, however, that investments in research and development, including the recruiting and hiring of software developers, are critical to remaining competitive in the marketplace and are directly related to continued timely development of new and enhanced products. Accordingly, we anticipate making continuing investments in the development of our application software products, including those targeted for the growing Internet market, as funds permit.

Sales and marketing expenses include salaries, commissions, travel expenses, and marketing expenses for our sales, marketing, customer support, and distribution consultants. Sales and marketing expenses also includes advertising, trade shows, public relations, and other market development programs. Sales and marketing expenses for the nine months ended September 30, 2001, were $104,251 compared to $390,285 for the nine months ended September 30, 2000 a decrease of $286,034. The decrease in sales and marketing expense is due to the lack of funds available to us for sales and marketing for the nine months ended September 30, 2001.

General and administrative expenses consist principally of administrative salaries and benefits, travel expenses, and related facilities costs for finance and administration, human resources, legal, and information services. General and administrative expenses for the nine months ended September 30, 2001 were $1,310,520 compared to $1,250,394 for the nine months ended September 30, 2000 an increase of $60,126. The increase in general and administrative expenses is due to increased expenses for outside legal and investment banking services related to the Company's efforts to obtain continuing sources of financing and its ongoing reporting obligations as a public reporting company. Increased employee costs related with increased staffing have also contributed to the increase in general and administrative expenses.

Interest expense and Financing expenses for the nine months ended September 30, 2001 were $329,606 compared to $52,772 for the nine months ended September 30, 2000 an increase of $276,834. We entered in various convertible notes, these notes contained a "beneficial conversion feature" Per Emerging Issues Task force (EITF) Number 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or contingently Adjustable Conversion Ratios", this beneficial conversion feature was assigned an intrinsic value of $260,350, as calculated under the provision of the EITF. This amount was immediately expensed, as the Notes were convertible into common shares of the Company at the time of the signing of the Agreement. The remaining interest of $69.256 is accrued interest on the Convertible Notes and interest paid on the $50,000 with the bank.

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THREE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2000.

For the three months ended September 30, 2001, sales were $555,550 compared to $68,406 for the three months ended September 30, 2000 an increase of $487,144. The increase in revenues is directly attributed to the sales generated from existing NATO contracts of FCL and sales generated from Advantage Systems.

For the three months ended September 30, 2001, direct cost of goods sold were $405,204 compared to $52,487 for the three months ended September 30, 2000 an increase of $352,717. The increase in direct cost of goods sold is directly attributed to the sales generated from the NATO contracts discussed above.

Research and development expenses for the three months ended September 30, 2001, were $87,521 compared to $52,803 for the three months ended September 30, 2000 an increase of $34,718. The increase is attributable to increase in related payroll and overhead expenses.

Sales and marketing expenses for the three months ended September 30, 2001, were $36,334 compared to $171,780 for the three months ended September 30, 2000 a decrease of $135,446. The decrease in sales and marketing expense is due directly to a lack of funds available in the third quarter of 2001.

General and administrative expenses for the three months ended September 30, 2001 were $329,252 compared to $755,221 for the three months ended September 30, 2000 a decrease of $425,969. The decrease in general and administrative expenses is due to the restructuring of administrative staff due to lack of financing. (see discussion in liquity)

Interest expense and Financing expenses for the three months ended September 30, 2001 were $222,872 compared to $11,104 for the three months ended September 30, 2000 and increase of $211,768. We entered in various convertible notes, these notes contained a "beneficial conversion feature" Per Emerging Issues Task force (EITF) Number 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or contingently Adjustable Conversion Ratios", this beneficial conversion feature was assigned an intrinsic value of $179,250, as calculated under the provision of the EITF. This amount was immediately expensed, as the Notes were convertible into common shares of the Company at the time of the signing of the Agreement. The remaining interest of $43,622 is accrued interest on the Convertible Notes and interest paid on the $50,000 with the bank

LIQUIDITY AND CAPITAL RESOURCES AS OF SEPTEMBER 30, 2001

In February 2001, we secured a $50,000 line of credit with a bank, at an interest rate of Wall Street Journal Prime Rate, plus 1.00% to be renewed annually. At September 30, 2001 the entire line was outstanding.

In March 2001, the Company entered into a $10,000,000 Equity line of Credit arrangement with Cornell Capital Ltd. Under the terms of the equity line agreement, the Company had the right to sell up to $10 million of its common stock. We could only access the equity line of credit upon the effectiveness of the registration statement we filed with the SEC. In July 2001 we withdrew our registration filing and in doing so our agreements with Cornell Capital Ltd were terminated.

In March 2001 and May 2001 we issued $250,000 and $500,000 respectively, convertible debentures. The notes bear an interest rate of 5% and 8%, respectively and are payable quarterly.

In August we entered into a short term financing agreement to borrow $550,000 from North Coast Investment Inc. The note will bear an interest rate of 10% and has a balloon payment in eight months. Additional terms were stipulated in the note making this agreement unfavorable for use. We have not nor do we intent to draw down on this note.

On September 1, 2001, Pacel Acquisitions Corp. a wholly owned subsidiary purchased the stock of Advantage Systems, Inc. a computer manufacture. Pacel Acquisitions Corp. will pay $70,000 and assume $238,727 in debt. On September 2001 Advantage Systems Inc. was merged into Pacel Corp., and is now a division of Pacel Corp. Pacel has entered into a letter of intent to secured a $1,000,000 convertible note to purchase this company and supply the necessary cash flow for the following year. The note bears and interest rate of 8%. These funds are designated only for the expenses related to the acquisition of Advantage Systems, Inc., and working capital for FCL and Advantage. We believe that the purchase of this company will give FCL the ability to sell our hardware rather than Gateway's or Dell's, to NATO. In doing so our margins will increase substantially. This company will also allow Pacel to use its established customer base for the distribution of its software products.

Due to lack of funding and withdrawal of the registration we began to lay off all nonessential personnel. We are in the process of renegotiating our current office leases to reduce office space. We are also evaluating all expenses and making the necessary cutbacks. We believe that with this reduction in expenses, convertible notes and sales, we will have sufficient working capital through the end of the year. Our ability to continue as a going concern beyond December 2001 is dependent upon being able to successfully secure long term financing either through the issuance of debt or equity.

Cash and cash equivalents increased to $175,247 for the period ended September 30, 2001 from $36,356 at December 31, 2000. Trade accounts receivable increased to $356,055 for the period ended September 30, 2001 compared to $9,883 at December 31, 2000. Other receivables decreased to $9,511 for the period ended September 30, 2001 compared to $64,760 at December 31, 2000. Accounts payable increased to $1,296,145 for the period ended September 30, 2001 compared to $491,926 at December 31, 2000. Net cash used for operating activities was $1,045,179 during the nine-month period ended September 30, 2001 compared to $2,576,903 in the corresponding period of 2000. Net cash used for operating activities primarily reflect the increase in account receivable, and inventory offset by accounts payable and loans to officers.

Net cash used in investing activities for the nine months ended September 30, 2001 and 2000 was $13,856 and $122,683 respectively. The outlay reflects the continual investment in computer related equipment for further development efforts.

Net cash provided by financing activities for the nine months ended September 30, 2001 and 2000 was $1,202,831 and $2,701,045, respectively. The funds were raised primarily through the issuance of convertible debentures in the period ended September 30, 2001. The funds raised for the period September 30, 2000 were raised in conjunction with the filing of an SB-2 registration statement to raise $3,000,000.