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PALWEB CORP  
Form 10QSB  
April 14, 2003

=====

U.S. SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-QSB

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED FEBRUARY 28, 2003

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

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

Commission file number 000-26331  
-----

PALWEB CORPORATION

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

OKLAHOMA  
-----

(State or other jurisdiction of  
incorporation or organization)

75-2954680  
-----

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

1607 WEST COMMERCE STREET  
-----

(Address of principal executive offices)

DALLAS, TEXAS 75208  
-----

(City, State and Zip Code)

(214) 698-8330  
-----

(Issuer's telephone number)

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common  
equity, as of the latest practicable date: APRIL 9, 2003 - 5,530,751

TRANSITIONAL SMALL BUSINESS DISCLOSURE FORMAT  
(CHECK ONE):

Yes  No

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PALWEB CORPORATION

FORM 10-QSB  
FOR THE PERIOD ENDED NOVEMBER 30, 2002

PART I. FINANCIAL INFORMATION

|  |      |
|--|------|
| ITEM 1. FINANCIAL STATEMENTS   | PAGE |
| Balance Sheets as of February 28,<br>2003 and May 31, 2002   | 1    |
| Statements of Operations<br>For the Nine Month Periods Ended<br>February 28, 2003 and 2002           | 2    |
| Statements of Operations<br>For the Three Month Periods Ended<br>February 28, 2003 and 2002          | 3    |
| Condensed Statements of Cash Flows<br>For the Nine Month Periods Ended<br>February 28, 2003 and 2002 | 4    |
| Notes to Financial Statements  | 5    |
| ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION                                    | 7    |
| ITEM 3. CONTROLS AND PROCEDURES  | 12   |
| PART II. OTHER INFORMATION   |      |
| ITEM 1. LEGAL PROCEEDINGS  | 13   |
| ITEM 2. CHANGES IN SECURITIES  | 13   |
| ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K   | 14   |
| SIGNATURE  | 15   |
| CERTIFICATIONS   | 16   |

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PALWEB CORPORATION  
CONSOLIDATED BALANCE SHEETS

February 28,  
2003  
-----

May 31,  
2002  
-----

ASSETS  
-----

CURRENT ASSETS:

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|  |              |              |
|--|--------------|--------------|
| Cash   | \$ 58,691    | \$ 13,521    |
| Accounts receivable  | 228,020      | 43,646       |
| Inventory  | 469,391      | 204,446      |
|  | -----        | -----        |
| TOTAL CURRENT ASSETS   | 756,102      | 261,613      |
| PROPERTY, PLANT AND EQUIPMENT, at cost   | 8,424,875    | 7,453,529    |
| Accumulated depreciation   | (652,736)    | (509,199)    |
|  | -----        | -----        |
| TOTAL PROPERTY, PLANT AND EQUIPMENT  | 7,772,139    | 6,944,330    |
| OTHER ASSETS   | 157,471      | 161,396      |
|  | -----        | -----        |
| TOTAL ASSETS   | \$ 8,685,712 | \$ 7,367,339 |
|  | =====        | =====        |
| LIABILITIES AND STOCKHOLDERS' EQUITY   |              |              |
| -----  |              |              |
| CURRENT LIABILITIES:   |              |              |
| Notes payable  | \$ --        | \$ 3,777,700 |
| Note payable-related party   | 401,952      | --           |
| Accounts payable and accrued liabilities   | 685,193      | 570,868      |
| Preferred dividends payable  | --           | 211,440      |
|  | -----        | -----        |
| TOTAL CURRENT LIABILITIES  | 1,087,145    | 4,560,008    |
| LONG-TERM DEBT-RELATED PARTY   | 7,000,000    | --           |
| STOCKHOLDERS' EQUITY:  |              |              |
| Preferred stock, \$.0001 par, 20,750,000<br>shares authorized; 750,000 outstanding                                   | 75           | 75           |
| Common stock, \$.0001 par value, 5,000,000,000<br>authorized; outstanding - 5,530,751 and<br>4,691,625, respectively | 553          | 469          |
| Additional paid-in capital   | 41,744,782   | 40,732,767   |
| Deficit  | (41,146,843) | (37,925,980) |
|  | -----        | -----        |
| TOTAL STOCKHOLDERS' EQUITY   | 598,567      | 2,807,331    |
|  | -----        | -----        |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY   | \$ 8,685,712 | \$ 7,367,339 |
|  | =====        | =====        |

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

1

PALWEB CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS

|                                       | Nine Months Ended<br>February 28, |           |
|---------------------------------------|-----------------------------------|-----------|
|                                       | 2003                              | 2002      |
|                                       | -----                             | -----     |
| SALES                                 | \$ 980,933                        | \$ 48,189 |
| COST OF SALES, including depreciation |                                   |           |

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|  |                |                |
|--|----------------|----------------|
| of \$136,890 and \$104,639, respectively | 1,901,067      | 399,814        |
|  | -----          | -----          |
| GROSS PROFIT (LOSS)                      | (920,134)      | (351,625)      |
| EXPENSES:                                |                |                |
| General and administrative expenses      | 1,051,634      | 1,059,612      |
| Impairment                               | 310,875        | --             |
| Interest expense                         | 262,437        | 115,943        |
|  | -----          | -----          |
| Total expenses                           | 1,624,946      | 1,175,555      |
|  | -----          | -----          |
| LOSS, BEFORE DISCONTINUED OPERATIONS     | (2,545,080)    | (1,527,180)    |
| LOSS FROM DISCONTINUED OPERATION         | --             | (132,224)      |
|  | -----          | -----          |
| NET LOSS                                 | \$ (2,545,080) | \$ (1,659,404) |
|  | =====          | =====          |
| LOSS PER COMMON SHARE:                   |                |                |
| LOSS BEFORE DISCONTINUED OPERATIONS      | \$ (0.64)      | \$ (0.33)      |
| DISCONTINUED OPERATIONS                  | --             | (0.03)         |
|  | -----          | -----          |
| LOSS PER COMMON SHARE                    | \$ (0.64)      | \$ (0.36)      |
|  | =====          | =====          |
| WEIGHTED AVERAGE SHARES OUTSTANDING      | 5,020,000      | 4,654,000      |
|  | =====          | =====          |

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

2

PALWEB CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS

|   | Three Months Ended<br>February 28, |          |
|---|------------------------------------|----------|
|   | 2003                               | 2002     |
|   | -----                              | -----    |
| SALES   | \$ 407,004                         | \$ 9,401 |
| COST OF SALES, including depreciation<br>of \$27,084 and \$46,367, respectively | 461,204                            | 84,761   |

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|                                       |                                |                                |
|---------------------------------------|--------------------------------|--------------------------------|
| GROSS PROFIT (LOSS)                   | -----<br>(54,200)              | -----<br>(75,360)              |
| EXPENSES:                             |                                |                                |
| General and administrative<br>expense | 299,353                        | 425,094                        |
| Impairment                            | --                             | --                             |
| Interest expense                      | 126,604                        | 10,849                         |
| Total expenses                        | -----<br>425,957               | -----<br>435,943               |
| LOSS, BEFORE DISCONTINUED OPERATIONS  | -----<br>(480,157)             | -----<br>(511,303)             |
| LOSS FROM DISCONTINUED OPERATION      | -----<br>--                    | -----<br>(27,406)              |
| NET LOSS                              | -----<br>\$ (480,157)<br>===== | -----<br>\$ (538,709)<br>===== |
| LOSS PER COMMON SHARE:                |                                |                                |
| LOSS BEFORE DISCONTINUED OPERATIONS   | \$ (0.14)                      | \$ (0.11)                      |
| DISCONTINUED OPERATIONS               | -----<br>--                    | -----<br>(0.01)                |
| LOSS PER COMMON SHARE                 | -----<br>\$ (0.14)<br>=====    | -----<br>\$ (0.12)<br>=====    |
| WEIGHTED AVERAGE SHARES OUTSTANDING   | -----<br>5,179,000<br>=====    | -----<br>4,665,000<br>=====    |

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

3

PALWEB CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | Nine Months Ended<br>February 28, |                        |
|--|-----------------------------------|------------------------|
|  | -----<br>2003<br>-----            | -----<br>2002<br>----- |
| CASH FLOWS FROM OPERATING ACTIVITIES:    |                                   |                        |
| Net cash used by continuing operations   | \$ (2,192,442)                    | \$ (2,885,145)         |
| Net cash used by discontinued operations | -----<br>--                       | -----<br>(38,254)      |
| Net cash flow used in operations         | -----<br>(2,192,442)              | -----<br>(2,923,399)   |

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|   |             |             |
|---|-------------|-------------|
| CASH FLOWS FROM INVESTING ACTIVITIES:               |             |             |
| Purchase of property and equipment                  | (1,282,221) | (3,905,567) |
| Decrease in loans receivable                        | --          | 617,124     |
| Proceeds from sale of equipment                     | --          | --          |
| Other   | (132,169)   | --          |
|   | -----       | -----       |
| Net cash used in investing activities               | (1,414,390) | (3,288,443) |
| CASH FLOWS FROM FINANCING ACTIVITIES:               |             |             |
| Proceeds from borrowings                            | 7,401,952   | 6,956,820   |
| Payments on notes payable                           | (3,777,700) | (185,091)   |
| Payments on savings certificates                    | --          | (1,357,306) |
| Sale of treasury stock                              | --          | 1,000,000   |
| Proceeds from issuance of<br>common/preferred stock | 27,750      | 522,676     |
|   | -----       | -----       |
| Net cash provided by financing<br>activities        | 3,652,002   | 6,937,099   |
|   | -----       | -----       |
| NET INCREASE IN CASH                                | 45,170      | 725,257     |
| CASH, beginning of period                           | 13,521      | 80,469      |
|   | -----       | -----       |
| CASH, end of period                                 | \$ 58,691   | \$ 805,726  |
|   | =====       | =====       |

NONCASH ACTIVITIES:

|  |            |           |
|--|------------|-----------|
| Issuance of common stock for:                                    |            |           |
| Payment of preferred dividends                                   | \$ 887,223 | \$ --     |
| Payment of liabilities and claims                                | 97,126     | --        |
| Issuance of preferred stock for:                                 |            |           |
| Retirement of debt   | --         | 6,440,579 |
| Acquisition of property  | --         | 725,344   |
| Debt assumed in acquisition of property                          | --         | 813,255   |
| Conversion of preferred stock to common                          | --         | 55        |
| Amortization of deferred income to<br>additional paid-in capital | --         | 82,388    |

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

PALWEB CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. In the opinion of the Company, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications, which are of a normal recurring nature, necessary to present fairly its financial position as of November 30, 2002, and the results of its operations and its cash flows for the nine month and three month periods ended February 28, 2003 and 2002. These consolidated financial statements should be read in conjunction with the consolidated financial statements as of and for the year ended May 31, 2002 and the notes thereto included in the Company's Form 10-KSB.

2. The results of operations for the nine month and three month periods ended February 28, 2003 are not necessarily indicative of the results to be expected for the full year.

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3. The computation of loss per share is computed by dividing the loss available to common stockholders by the weighted average shares outstanding for the periods. For the nine month and three month periods ended February 28, 2003, loss available to common stockholders is determined by adding preferred dividends for the periods in the amounts of \$675,783 and \$226,849, respectively, to the loss from continuing operations and to net loss. There were no preferred dividends for the comparable periods ended February 28, 2002. For the nine month periods ended February 28, 2003 and 2002, the average common shares outstanding are 5,020,000 and 4,654,000, respectively. For the three month periods ended February 28, 2003 and 2002, the average common shares outstanding are 5,179,000 and 4,665,000, respectively. Convertible preferred stock is not considered as its effect is antidilutive.

4. PalWeb incurred an expense of \$310,875 in fiscal year 2003 to record the impairment of certain production equipment. PalWeb wrote down the cost of its original prototype injection molding machine and related molds to the value of the expected future cash flows.

5. Effective October 17, 2002, PalWeb's Board of Directors authorized the issuance of 15,584 shares of common stock at the then market rate of \$1.50 per share to Paul Kruger in payment of \$23,376 of accrued interest as of October 31, 2002, on notes payable to Mr. Kruger.

6. During the nine month period ended February 28, 2003, the Board of Directors authorized dividends on the Series 2001 preferred stock in the total amount of \$675,783. Further, the board authorized payment of unpaid preferred dividends in the form of restricted common stock at the then market rate as follows:

5

| Date of Dividend<br>----- | Amount<br>----- | Stock Price<br>----- | Common Shares<br>----- |
|---------------------------|-----------------|----------------------|------------------------|
| 3/31/02                   | \$211,440       | \$1.60               | 132,150                |
| 6/31/02                   | 225,000         | 1.60                 | 140,625                |
| 9/30/02                   | 223,934         | 1.50                 | 148,589                |
| 12/31/02                  | 226,849         | 0.63                 | 360,078                |

The board also authorized that, until further notice, future dividends on the Series 2001 preferred stock will be paid in the form of common stock based on the average stock price as of the date of record.

7. See "Management Discussion and Analysis, Liquidity and Capital Resources," for discussion regarding a \$500,000, 9% interest, unsecured note payable due March 4, 2003 and a line of credit provided by Paul Kruger through issuance of a \$7,000,000 note payable at 3% above prime rate of interest, due June 4, 2004.

6

ITEM 2. MANAGEMENT DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

RESULTS OF OPERATIONS

-----

GENERAL TO ALL PERIODS

The consolidated statements include PalWeb and its wholly-owned subsidiary, Plastic Pallet Production, Inc. ("PPP").

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

### SALES

PalWeb's primary business is the manufacturing and selling of plastic pallets, which is referred to herein as continuing operations. During the period ended February 28, 2003, PalWeb has continued to explore the possible marketing of its patent-pending PIPER 600 equipment to third parties; however generating pallet sales remain the company's main focus. PalWeb's primary marketing efforts are the development of distributors in key geographic locations and attendance at material handling trade shows.

PalWeb has a production capacity of approximately 40,000 pallets per month. During the nine months ended February 28, 2003, pallet production averaged about 13% of capacity. Future production levels will be maintained as sales dictate. There is no assurance that PalWeb will receive orders for pallets that will maintain, or justify any significant increase to, PalWeb's current production levels.

### PRODUCTS

PalWeb currently has three series of plastic pallets: Hawker, Granada and Tank. The following is a description of each series and its pallet line.

- o HAWKER SERIES PalWeb's Hawker Series pallets are all manufactured using the Company's proprietary fire retardant plastic blend.
  - o THE HAWKER 4840 PICTURE-FRAME o THE HAWKER 4840 PICTURE-FRAME interlocking pallet is the first in the Hawker Series. The Hawker 4840 utilizes a patented inter-locking design featuring CJ2TM fire retardant polymers that are UL 2335 certified. The Hawker 4840 has a static load capacity of 25,000 lbs., a dynamic load of 5,000 lbs., and a rackable load of 2,500 lbs., and weighs approximately 53 lbs.
- o GRANADA SERIES The Granada series of pallets are manufactured using a blend of recycled plastic developed by the Company. The Granada series features a picture frame, nestable, stackable and three-runner pallet.

7

- o THE GRANADA PICTURE FRAME PALLET utilizes the patented inter-locking design, and has a dynamic load of 5,000 lbs., a rackable load of 2,800 lbs., and a static load of 25,000 lbs., and weighs approximately 47.5 lbs.
- o THE GRANADA STACKABLE PALLET, which consists of the tops of the Granada Picture Frame, has a dynamic load of 5,000 lbs. and a static load of 7,000 lbs. The Granada Stackable weighs approximately 32 lbs.
- o THE GRANADA NESTABLE PALLET features a dynamic load of 5,000 lbs. and a static load of 7,000 lbs. The Granada Nestable weighs approximately 30 lbs.
- o THE GRANADA THREE-RUNNER PALLET with a free-span racking capacity of 1,200 lbs., features a dynamic load of 5,000 lbs. and a static load of 12,000 lbs. The Granada Three-Runner which weighs approximately 41



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lbs., utilizes a design that allows for easier handling by pallet jacks.

- o TANK SERIES PalWeb's Tank Series pallets are manufactured using virgin materials developed by the Company. The Tank Picture Frame Pallet is the first in the Tank Series.
- o The Tank Picture Frame Pallet which features the patented interlocking design, has a static load of 30,000 lbs., a rackable load of 3,000 lbs., and a dynamic load of 5,000 lbs., and weighs approximately 50 lbs.

The Hawker 4840, Granada Picture Frame, Granada Three- Runner and Tank Picture Frame all successfully passed the CONTAINER TECHNOLOGIES LABORATORY INC., TEST ASTM D1185-98A which included open rack bend, compression, free fall impact, random vibration and incline impact tests.

### PERSONNEL

PalWeb had approximately 18 full-time and 18 temporary employees. Temporary employees are used to supplement the manufacturing process as necessary

### TAXES

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

8

### NINE MONTH PERIOD ENDED FEBRUARY 28, 2003, COMPARED TO NINE MONTH PERIOD ENDED FEBRUARY 28, 2002

Sales for the nine month period ended February 28, 2003, were \$980,933 compared to \$48,189 in fiscal year 2002, an increase of 1,935 %. The increase of \$932,744 represents PalWeb's ongoing efforts to market its products as described above. However, sales revenues remain insufficient to cover material and operating costs.

Cost of sales was \$1,901,067 in fiscal year 2003 compared to \$399,814 in 2002 for an increase of \$1,501,253. This increase is primarily due to a combination of (1) start-up costs primarily in the first quarter of fiscal year 2003 necessary for the operation of the new production line and upgrade the original prototype equipment to produce nestable pallets and (2) costs related to the increased production including the addition of another production shift, materials, depreciation and utilities. Additional personnel may be required as sales continue to increase.

General and administrative expenses decreased \$7,978 from \$1,059,612 in fiscal year 2002 to \$1,051,634 in fiscal year 2003. The general and administrative costs in fiscal year 2003 include an \$83,750 settlement of a claim by Roger Landress through payment of \$50,000 cash and the issuance of 15,000 shares of common stock. Additionally, salaries increased approximately \$144,000 as a result of the increase in production and sales activity offset by a decreases in rent of about \$136,000 due to the purchase of the plant and certain development costs incurred in fiscal year 2002 of about \$130,000.

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During the period ended February 28, 2003, PalWeb wrote down the cost of its original prototype injection molding machine and related molds. An expense of \$310,875 was recorded to reduce the cost of this equipment to the expected future cash flows.

Interest expense increased \$146,494 from \$115,943 in fiscal year 2002 to \$262,437 in fiscal year 2003. The debt outstanding at November 30, 2001, was exchanged for preferred stock on January 4, 2002, resulting in essentially no interest expenses from then through February 28, 2002. Additionally, as discussed below, effective January 4, 2003, Paul Kruger entered into a loan agreement providing a \$7,000,000 loan at three points above the prime rate of interest due June 4, 2004.

The loss from continuing operations increased \$1,017,900 from \$1,527,180 for fiscal year 2002 to \$2,545,080 for fiscal year 2003.

After deducting the loss from discontinued operations in fiscal year 2002, the net loss is \$1,659,404, or \$0.36 per share, compared to a net loss of \$2,545,080 or \$0.64 per share in fiscal year 2003 for an increase of \$885,676. The per share value in fiscal year 2003 includes the effect of preferred dividends as discussed in note 3 to the financial statements.

9

THREE MONTH PERIOD ENDED FEBRUARY 28, 2003, COMPARED TO THREE MONTH PERIOD ENDED FEBRUARY 28, 2002

Sales for the three month period ended February 28, 2003 were \$407,004 compared to \$9,401 in 2002. The increase is \$397,603 and represents PalWeb's ongoing sales efforts as described above. During fiscal 2002, PalWeb's primary emphasis was completion of its new production line.

General and administrative expenses decreased \$125,741 from \$425,094 for fiscal year 2002 to \$299,353 for fiscal year 2003. This decrease is principally due to product development costs incurred in fiscal 2002.

Interest expense increased \$115,755 from \$10,849 in fiscal year 2002 to \$126,604 in fiscal year 2003. The debt outstanding at November 30, 2001, was exchanged for preferred stock on January 4, 2002, resulting in essentially no interest expenses from then through February 28, 2002. Additionally, as discussed below, effective January 4, 2003, Paul Kruger entered into a loan agreement providing a \$7,000,000 loan at three points above the prime rate of interest due June 4, 2004.

The loss from continuing operations decreased \$31,146 from \$511,303 in fiscal year 2002 to \$480,157 in fiscal year 2003.

After deducting the loss from discontinued operations in fiscal year 2002, the net loss is \$538,709, or \$0.12 per share, compared to a net loss of \$480,157 or \$0.14 per share in fiscal year 2003 for an decrease of \$58,522. The per share value in fiscal year 2003 includes the effect of preferred dividends as discussed in note 3 to the financial statements.

### LIQUIDITY AND CAPITAL RESOURCES

-----

#### GENERAL

Currently, PalWeb's management projects that sales of approximately 15,000 pallets per month will generate revenue of approximately \$450,000 which should provide sufficient cash flow to sustain its operations including cash operating

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expenses for labor, recurring overhead and interest and material costs. Although significant sales orders have been executed, there is no assurance that this sales level will be achieved. Until sales reach this level, PalWeb will remain dependent on outside sources of cash to fund its operations as its sales revenues will be insufficient to meet current liabilities.

PalWeb has had difficulty in obtaining financing from traditional financing sources. As described below, substantially all of the financing that PalWeb has received through February 28, 2003, has been provided by loans from entities controlled by Mr. Paul Kruger and entities affiliated with Warren Kruger, President and a director of PalWeb, and through the offering of 2001 Preferred Stock described below to the same persons. PalWeb is currently reliant on loans provided by Paul

10

Kruger and Warren Kruger. There is no assurance that Paul Kruger or Warren Kruger will continue to provide loans or loan guarantees in the future. Further, Paul Kruger maintains his position as a primary stockholder of PalWeb but is no longer an officer or director.

### LINE OF CREDIT

Effective December 31, 2002, an affiliated company of Warren Kruger entered into a loan agreement with PalWeb to provide a \$500,000 line of credit at 9% due March 4, 2003, with automatic 30-day extensions until lender shall have given notice at least ten days prior to any scheduled maturity. At February 28, 2003, the outstanding balance due on the note is \$401,952.

Effective January 10, 2003, PalWeb and its subsidiary, PPP, entered into a loan agreement with Paul Kruger providing a line of credit of \$7,000,000 at 3% above the prime rate of interest due June 4, 2004. Proceeds of the loan were used to pay the outstanding debt of F&M Bank and Trust Company ("F&M") and the mortgage loan with Texas Capital Bank. Pursuant to the loan agreement, PalWeb and PPP granted to Mr. Kruger a lien on all PPP assets, and PalWeb has granted to Mr. Kruger a pledge of its stock in PPP. In addition, Mr. Paul Kruger, along with an officer and two employees associated with him, and Lyle Miller, a director, resigned their employment and director positions with PalWeb as of January 10, 2003 and:

- (1) Those resigning received extensions on employee common stock options for a period of five years at the same exercise price.
- (2) Mr. Kruger received a distributor agreement to acquire pallets at PPP's F.O.B. price at PPP's plant, less the greatest discounts or concessions made to any of PPP's other distributors for similar kinds and quantities of products. The agreement may be terminated by either party upon thirty (30) days notice.
- (3) Mr. Kruger received an assignment of a \$20,000,000 default judgement that PalWeb holds in its favor against Ullrich Wolfgang, a German citizen. PalWeb has the option to participate in any or all of the assignment by electing to pay its pro rata share of the costs associated with pursuit of collection.

### OTHER

PalWeb has accumulated a working capital deficit of approximately \$331,000 at February 28, 2003, which includes \$402,000 due to Warren Kruger and \$685,000

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in accounts payable and accrued liabilities. The working capital deficit reflects the uncertain financial condition of PalWeb resulting from its inability to obtain long term financing. There is no assurance that PalWeb will secure such financing.

Because of its need to secure additional funding to sustain its operations, PalWeb has inquired among the holders of PalWeb's outstanding Series 2001 12% Cumulative Convertible

11

Senior Preferred Stock ("Series 2001 Preferred Stock") to assess such holders' interest in participating in a new private preferred stock offering of up to \$5,000,000. The terms of any such offering would be negotiated and established by PalWeb and any prospective purchasers of the securities if PalWeb receives positive expressions of interest from holders of the 2001 Preferred Stock, which PalWeb hopes to obtain within the next thirty to sixty days. In addition, PalWeb has engaged the services of Stonegate Securities, Inc., as investment advisor, to assist PalWeb to seek additional sources of private equity financing. PalWeb hopes to receive a report from Stonegate within the next thirty to sixty days. The terms of any resulting securities offering would be subject to negotiation with interested investors. There is no certainty that these efforts will result in the offering and issuance of any additional securities.

PalWeb continues to be dependent upon Paul Kruger and Warren Kruger to provide and/or secure additional financing and there is no assurance that either will do so. As such, there is no assurance that funding will be available for PalWeb to continue operations.

### MATERIAL RISKS

-----

PalWeb has incurred significant losses from operations and there is no assurance that it will achieve profitability or obtain funds to finance continued operations. For other material risks, see PalWeb's Form 10-KSB for the period ended May 31, 2002, which was filed on September 13, 2002.

### ITEM 3. CONTROLS AND PROCEDURES

PalWeb's Chief Executive Officer and Chief Financial Officer (collectively, the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures. Such officers have concluded that PalWeb's disclosure controls and procedures are effective to ensure that information required to be disclosed by PalWeb in this report is accumulated and communicated to allow timely decisions regarding required disclosure.

The Certifying Officers also have indicated that there were no significant changes in PalWeb's internal controls or other factors that could significantly affect such controls as of the date of this report.

12

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

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As more fully reported under Item 3, Litigation, in PalWeb's Form 10-KSB for the fiscal year ended May 31, 2002, which was filed on September 13, 2002, PalWeb obtained an order directing Vimonta to show cause in writing why default judgment should not be entered against Vimonta and subsequently obtained an order granting default judgment against Vimonta and dismissing Vimonta's counterclaim. PalWeb thereafter sought permission from the court to allow PalWeb to effect service of both of such orders upon Vimonta pursuant to the provisions of the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents (the "Convention") to make certain that proper service is obtained for entry of the default judgment. The court granted PalWeb's request, and PalWeb has accomplished service pursuant to the Convention. Vimonta has submitted responses to the court, and the matter is pending.

In connection with the January 2003 financing provided to PalWeb by Paul Kruger, PalWeb's former Chairman and Chief Executive Officer, PalWeb and PPP agreed to assign to Mr. Kruger any judgment obtained against Vimonta, and Mr. Kruger agreed to reimburse to PalWeb and PPP any costs incurred by them after January 10, 2003, in connection with the perfection and enforcement of the Vimonta judgment. For further discussion of the financing provided by Mr. Kruger, see "Paul Kruger Financing" under "Liquidity and Capital Resources" under Item 2 of PalWeb's Form 10-QSB for the quarterly period ended November 30, 2002, filed on January 14, 2003.

### ITEM 2. CHANGES IN SECURITIES

Holders of PalWeb's Series 2001 12% Cumulative Convertible Senior Preferred Stock ("2001 Preferred Stock") are entitled to cumulative dividends of 12% per annum, \$1.20 per share, or a total of \$900,000. In lieu of the quarterly payment of cash dividends of \$226,849 due on December 31, 2002, the holders of such 2001 Preferred Stock agreed to accept common stock of PalWeb, and PalWeb's Board of Directors approved the payment of such dividends in the form of 360,078 shares of the authorized but unissued shares of the company's common stock at an effective price of \$0.63 per share as of the date such payment of shares was authorized.

PalWeb relied on the exemption set forth in Section 4(2) of the Securities Act of 1933, as amended, in connection with the issuance of the stock and the stock dividend set forth above. All parties listed above are sophisticated persons or entities. All of the purchasers executed investment letters representing that they had sufficient access to information to make the investment and acknowledging the restrictions on transfer of the stock. There was no underwriting, and no commissions were paid to any party upon the issuance of such stock.

13

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### A. Exhibits

- 11.1 Computation of Loss per Share is in Note 3 in the Notes to the financial statements.
- 99.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C.ss.1350 (submitted herewith).
- 99.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C.ss.1350 (submitted herewith).

#### B. Reports on Form 8-K

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There were no reports on Form 8-K filed by PalWeb during the three months ended February 28, 2003.

14

SIGNATURE

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PALWEB CORPORATION

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(Registrant)

Date: April 14, 2003

/s/ Warren F. Kruger

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Warren F. Kruger  
President and CEO

CERTIFICATIONS

I, Warren F. Kruger, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of PalWeb Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

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6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 14, 2003

/s/ Warren F. Kruger

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Warren F. Kruger  
President and CEO  
(Principal Executive Officer)

17

CERTIFICATIONS

I, William W. Rahhal, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of PalWeb Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to



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record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

18

- 6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 14, 2003

/s/ William W. Rahhal

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William W. Rahhal  
Chief Financial Officer  
(Principal Financial Officer)

19