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PACEL CORP
Form 10QSB
August 22, 2005

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

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

For the quarterly period ended June 30, 2005

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)

NEVADA

54-1712558

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

7621 Little Ave Suite 101
Charlotte, NORTH CAROLINA

28226

(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 August 19, 2005 there were 463,440,333 shares of the Registrant's common stock outstanding.

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PACEL CORP. AND SUBSIDIARIES

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PACEL CORP. AND SUBSIDIARIES
Consolidated Balance Sheets

| | June 30, 2005 |
|--|----------------------|
| | ----- (Unaudited) |
| ASSETS ----- | |
| Current assets: | |
| Cash | \$ 550,386 |
| Client deposit and advance payments | 66,129 |
| Accounts receivable | 17,873 |
| Accounts receivable-Unbilled | 393,190 |
| Prepaid expenses | 78,906 |
| Workers compensation insurance deposits | 92,825 |
| Restricted cash | 228,114 |
| | ----- |
| Total current assets | 1,427,423 |
| | ----- |
| Property and equipment, net of accumulated depreciation of \$100,355 and \$70,436, respectively | 156,316 |
| | ----- |
| Other assets: | |
| Allegro receivable | 104,034 |
| Retirement Plan-Director | 138,436 |
| Goodwill | 465,423 |
| Security deposits | 18,358 |
| | ----- |
| Total other assets | 726,251 |
| | ----- |
| Total assets | \$ 2,309,990 |
| | ===== |

See accompanying notes to the consolidated financial statements.

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PACEL CORP. AND SUBSIDIARIES
Consolidated Balance Sheets

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| | June 30, 2005 |
|---|----------------------|
| | ----- (Unaudited) |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | |
| Current liabilities: | |
| Accounts payable | \$ 599,894 |
| Payroll and payroll related liabilities | 2,101,292 |
| Accrued worksite employee payroll expense | 376,429 |
| Accrued expenses | 1,747,979 |
| Assumed Liabilities | 493,133 |
| Client deposits and advance payments | 66,129 |
| Prepaid Payroll | 30,353 |
| Short term payables | 2,528,213 |
| Sales taxes payable | 676 |
| | ----- |
| Total current liabilities | 7,944,098 |
| Long-term liabilities: | |
| Notes Payable | 232,187 |
| Deferred Compensation-Director Payable | 138,436 |
| | ----- |
| Total long term liabilities | 370,623 |
| Total liabilities | 8,314,721 |
| Stockholders' equity (deficit): | |
| Preferred stock, .001 par value, no liquidation value, 5,000,000 shares authorized, 1,000,000 shares of 1997 Class A convertible preferred stock issued | 1,000 |
| Common stock, .001 par value, 10,000,000,000 shares authorized, 50,975,944 and 1,773 shares issued respectively | 50,976 |
| Additional paid-in capital | 23,239,158 |
| Cumulative currency translation adjustment | (18,720) |
| Accumulated deficit | (29,277,145) |
| | ----- |
| Total stockholders' (deficit) | (6,004,731) |
| | ----- |
| Total liabilities and stockholders' deficit | \$ 2,309,990 |
| | ===== |

See accompanying notes to the consolidated financial statements.

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Consolidated Statements of Operations (Unaudited)

| | Six months ended | |
|--|------------------|----------------|
| | 2005 | 2004 |
| | ----- | ----- |
| Revenue | \$ 1,490,511 | \$ 1,677,963 |
| Cost of services | 1,177,739 | 1,294,127 |
| | ----- | ----- |
| Gross profit | 312,772 | 383,836 |
| Operating costs and expenses: | | |
| General and administrative | 1,500,434 | 1,069,695 |
| Sales and marketing | 350,138 | 145,197 |
| Depreciation and amortization | 29,920 | 13,496 |
| Loss on impairment of goodwill | 131,950 | -0- |
| | ----- | ----- |
| Total operating expenses | 2,012,442 | 1,228,388 |
| | ----- | ----- |
| Operating Loss | (1,699,670) | (844,552) |
| Other expenses: | | |
| Interest expense | (232,708) | (106,181) |
| Financing costs | (362,143) | (1,355,714) |
| | ----- | ----- |
| Total other expense | (594,851) | (1,461,895) |
| Net loss before discontinued operations | (2,294,521) | (2,306,447) |
| Discontinued operations: | | |
| Loss from discontinued operations of Asmara of Florida and Partners PEO of the Carolinas | (134,708) | (171,680) |
| Loss from sale of assets to Allegro, Inc. | (485,953) | -0- |
| | ----- | ----- |
| Total loss on discontinued operations | (620,661) | (171,680) |
| Net loss | \$ (2,915,182) | \$ (2,478,127) |
| | ===== | ===== |
| Loss from discontinued operations per common and common equivalent share: | | |
| Basic | \$ (0.02) | \$ (171,680) |
| Diluted | \$ (0.02) | \$ (171,680) |
| Loss from sale of assets per common and common equivalent share: | | |
| Basic | \$ (0.06) | \$ -0- |
| Diluted | \$ (0.06) | \$ -0- |
| Net loss per common and common equivalent share: | | |
| Basic | \$ (0.34) | \$ (2,478,127) |
| Diluted | \$ (0.34) | \$ (2,478,127) |
| Weighted average shares outstanding: | | |
| Basic | 8,622,532 | 1 |
| Diluted | 8,622,532 | 1 |

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

| | Six months end June 30, | |
|--|----------------------------|-------|
| | 2005 | |
| | ----- | ----- |
| Cash flows from operating activities: | | |
| Net loss | \$ (2,915,182) | \$ |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation | 29,920 | |
| Embedded interest | 362,143 | |
| Other non-cash items | 27,700 | |
| Loss on discontinued operations | 103,000 | |
| Loss on sale of assets | 485,954 | |
| Loss on impairment of goodwill | 131,950 | |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in assets: | | |
| Accounts receivable | 212,597 | |
| Accounts receivable-Unbilled | (82,345) | |
| Other receivables | -0- | |
| Client deposits | 760,469 | |
| Insurance deposits | 46,263 | |
| Prepaid expenses | 50,400 | |
| Security deposits | (1,926) | |
| Increase (decrease) in liabilities: | | |
| Accounts payable | 357,684 | |
| Accrued expenses | 417,522 | |
| Accrued expenses-Director | -0- | |
| Payroll and payroll related liabilities | (416,050) | |
| Accrued work site employee payroll cost | 76,038 | |
| Deferred revenue | (760,469) | |
| Assumed liabilities | -0- | |
| Prepaid payroll | 30,353 | |
| Sales and income taxes payable | 676 | |
| | ----- | ----- |
| Net cash (used in) operating activities | (1,083,303) | |
| Cash flows from investing activities: | | |
| Net purchases of property and equipment | (13,385) | |
| Cash received from sale of assets | 18,022 | |
| Cash CD-Restricted | 684,895 | |
| | ----- | ----- |
| Net cash (used in) investing activities | 689,532 | |
| Cash flows from financing activities: | | |
| Repayments of notes payable | (12,685) | |
| Issuance of notes payable | -0- | |
| Issuance of convertible notes payable | 845,000 | |
| Repayments of lines of credit | (5,210) | |
| Repayments of capital lease | -0- | |
| | ----- | ----- |
| Net cash provided by financing activities | 827,105 | |
| | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents | 433,334 | |
| Cash and cash equivalents, beginning of period | 117,052 | |

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| | | |
|--|------------|-------|
| | ----- | ----- |
| Cash and cash equivalents, end of period | \$ 550,386 | \$ |
| | ===== | ===== |

See accompanying notes to the consolidated financial statements.

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

| | | |
|--|-----------|------------------------------|
| | | Six months ended June 30, |
| | | 2005 |
| | ----- | ----- |
| Supplemental disclosure of cash flow information: Cash paid during the years | | |
| for: | | |
| Interest | \$ 11,410 | \$ |
| Income taxes | \$ -0- | \$ |

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See accompanying notes to the consolidated financial statements.

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PACEL CORP. AND SUBSIDIARIES Notes to the Consolidated Financial Statements June 30, 2005

Note 1. Basis of Presentation.

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

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

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, 2004. 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.

Note 2. Use of Estimates

Our consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (US GAAP). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts in the financial statements and accompanying notes. These estimates form the basis for judgments we make about the carrying values of assets and liabilities that are not readily apparent from other sources. We base our estimates and judgments on historical experience and on various other assumptions that we believe are reasonable under the circumstances. However, future events are subject to change and the best estimates and judgments routinely require adjustment. US GAAP requires us to make estimates and judgments in several areas, including those related to impairment of goodwill and equity investments, revenue recognition, recoverability of inventory and receivables, the useful lives of long lived assets such as property and equipment, the future realization of deferred income tax benefits and the recording of various accruals. The ultimate outcome and actual results could differ from the estimates and assumptions used.

Note 3. Revenue Recognition.

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We account for our revenues in accordance with Emerging Issues Task Force ("EITF") 99-19, Reporting Revenues Gross as a Principal Versus Net as an Agent. Our revenues are derived from our billings, which are based on:

- o the payroll cost of our worksite employees; and
- o a markup computed as a percentage of the payroll cost.

In determining the pricing of the markup component of the billings, we consider our estimates of the costs directly associated with our worksite employees, including payroll taxes and workers' compensation costs, plus an acceptable gross profit margin. We invoice the billings concurrently with each periodic payroll of our worksite employees. Revenues, which exclude the payroll cost component of billings, are recognized ratably over the payroll period as worksite employees perform their service at the client worksite. We include revenues that have been recognized but not invoiced in unbilled accounts receivable on our Consolidated Balance Sheets.

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PACEL CORP. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements
June 30, 2005

Note 3. Revenue Recognition.

Our revenues are primarily dependent on the number of clients enrolled, the resulting number of worksite employees paid each period. Because our markup is computed as a percentage of payroll cost, revenues are also affected by the payroll cost of worksite employees, which can fluctuate based on the composition of the worksite employee base, inflationary effects on wage levels and differences in the local economies of our markets.

The primary direct costs associated with our revenue generating activities are:

- o employment-related taxes ("payroll taxes");
- o workers' compensation claim costs.

Payroll taxes consist of the employer's portion of Social Security and Medicare taxes under FICA, federal unemployment taxes and state unemployment taxes. Payroll taxes are generally paid as a percentage of payroll cost. The federal tax rates are defined by federal regulations. State unemployment tax rates are subject to claim histories and vary from state to state.

No allowance for doubtful accounts has been made.

Note 4. Common Stock.

In February and June 2005, the Company effected a one-for-one thousand reverse stock split restating the number of common shares of the Company at December 31, 2004 from 1,773,000,943 to 1,773. All references to average number of shares, shares outstanding and prices per share have been restated retroactively to reflect the split.

Note 5. Stock Compensation.

The Company issued stock to certain officers, key employees, and

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non-employee directors which consisted of Series "B" Preferred Stock (Series "B" Stock). The maximum number of shares of the Company's Series "B" Stock available for issuance was 1 million shares with a par value of \$0.001. Each share of the Series "B" Stock is convertible to 50 shares of Common Stock without the payment of any additional consideration. Shares issues are compensation to the recipients.

Effective June 30, the Company authorized and issued 1,000,000 shares of Series "B" Preferred Stock to officers and directors of the Company.

The Company determined compensation costs based on the fair value at the grant date for its stock. The value of each share price was determined to be .0277 representing \$27,700 in total compensation. The Company used the Black-Scholes option-pricing model.

On June 30, the holders of the Series "B" Stock elected to convert all of their shares to 50,000,000 shares of Common Stock.

The Black-Scholes option valuation model was developed for estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Because option valuation models require the use of subjective assumptions, changes in these assumptions can materially affect the fair value of the options, and the Company's options do not have the characteristics of traded options, the option valuation models do not necessarily provide a reliable measure of the fair value of its options.

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PACEL CORP. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements
June 30, 2005

Note 6. Acquisitions.

In January 2005, the Company, through its wholly-owned subsidiary The Resourcing Solutions Group, Inc., completed the acquisition of certain assets of Rossar HR LLC, a Pennsylvania limited liability company, which operated under the name "Your Staff Solutions". Rossar HR LLC is a Professional Employment Organization founded in 1987 which specializes in quality human resource management services for small to medium sized businesses. Consideration under such agreement did 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. The Company recorded the acquisition as a purchase and recorded \$52,000 of fees and \$232,950 of goodwill in association with this acquisition. The Company acquired assets consisting of office equipment and cash on hand totaling \$45,170 and assumed liabilities equal to \$6,100. During the first quarter of 2005, the Company recorded an impairment of \$131,950 reducing the value of goodwill to \$101,000.

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

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"scheme," the Company and its former 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 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 and Calkins answered the second amended complaint on March 23, 2005. On April 7, 2005, a federal grand jury in the Northern District of Illinois returned an indictment charging Custable and ten other individuals and entities (The Company was not indicted) with engaging in a fraudulent scheme based on the same allegations as the SEC's action. On April 21, 2005, the District Court stayed the SEC's civil action pending resolution of the criminal action.

Note 8. Customer Deposit.

The Company had \$66,129 in Deferred Revenue on June 30, 2005 related to amounts prepaid for 2005 services from a single client. The Company executed a letter agreement in conjunction with receipt of these funds that provides the funds be held in separate trust account by the Company and not commingled with any other general use funds of the Company. The Company draws down the pre-payment account as needed to fund the payment of payroll, deposit taxes, benefits, fees and other costs for this single client pursuant to the agreement. The funds are required to be held in a separate trust account and at the present time, the funds are commingled in our operating account which is a violation of the agreement.

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PACEL CORP. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements
June 30, 2005

Note 9. Short-Term Payables consists of:

| | June 30, 2005 | December 31 2004 |
|---------------------------|------------------|---------------------|
| | ----- | ----- |
| Convertible Notes Payable | \$ 2,017,066 | \$ 1,669,020 |
| Other Notes Payable | 465,000 | 465,000 |
| Rossar Note Payable | 27,127 | - |
| Bank Line of Credit | 19,020 | 24,230 |
| | ----- | ----- |
| Total Short-Term Payables | \$ 2,528,213 | \$ 2,158,250 |
| | ===== | ===== |

Note 10. Discontinued Operations.

On May 15, 2005, The Resourcing Solutions Group, Inc. a subsidiary of the Company, discontinued the operation of Asmara of Florida and Partners PEO of the Carolinas. The Company reported a loss from

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discontinued operations for the six months ended June 30, 2005 and 2004 equal to \$134,708 and \$171,680 respectively. The consolidated financial statements have been restated, where applicable, to reflect the discontinued operations.

Note 11. Disposition of Assets.

On May 15, 2005, The Resourcing Solutions Group, Inc., a subsidiary of the Company, sold all the assets of Asmara of Florida, Partners PEO of the Carolinas, and Asmara Services II, Inc. to Allegro, Inc. for \$122,055 and reported a loss of \$485,953, of which \$608,008 was goodwill. The Company will receive the \$122,055 over the next 12 months as it's earned as part of the agreement.

Note 12. Related Party Transactions.

A. Employment Agreements

In July 2005, The Company entered into a ten year employment contracts with F. Kay Calkins. Compensation will include an annual base salary of \$240,000 of which \$60,000 is deferred until July 2006. Ms. Calkins is entitled to 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. Ms. Calkins will hold the title of Chairman of the Board of Directors.

In July 2005, Mr. Calkins resigned as Chairman and Member of the Board of Directors. Mr. Calkins was terminated as an employee of the Company. The Company is currently negotiating a Termination Agreement with Mr. Calkins.

Note 13. Recent Accounting Pronouncements.

The Company believes that any new accounting pronouncements since December 31, 2004, will not have an affect on the Company's financial statements.

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PACEL CORP. AND SUBSIDIARIES

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

Management's discussion and analysis of results of operations and financial condition include a discussion of liquidity and capital resources. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto. Historical results are not necessarily indicative of trends in operating results for any future period.

In 2005, 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

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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. 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 successfully negotiated joint marketing programs to market the company's products and services. 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 became fully operational in January 2005.

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.

In a further effort to bring the Company to profitability it evaluated its internal operating costs and evaluated each existing client to determine profitability. The Company determined that certain clients were not producing sufficient gross profit. In May 2005, the Company sold 16 contracts to Allegro, Inc. for \$122,055. The Company recorded a receivable for \$122,055 that will be collected over the next 12 months. The balance of this receivable at the quarter ended June 30, 2005, was \$104,034.

Commensurate with the sale of the 16 accounts the Company reorganized its operations. The Company reduced its internal staff, and other operating costs to the level necessary to serve the existing client base. With the new HRIS system becoming operational the Company will be able to add additional clients without increasing its operational staff. The reorganization reduces the Company's heavy industry and "blue collar" client base allowing it to expand at a greater pace in other economic sectors. The targeted clients to which the Company is marketing its services have a greater capability to the more automated process integral to the new HRIS system. The reorganization also reduced the Company's reliance on outside equity funding.

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of Operations.

Six Months ended June 30, 2005 compared to the Six Months ended June 30, 2004

Revenue for the six months ended June 30, 2005 was \$1,490,511 compared to revenue of \$1,677,963 for the six months ended June 30, 2004. Revenues generated from the Rossar acquisition accounted for \$268,858 of the increase offset by a decrease of \$456,310 from the Company's existing clients.

The company experienced a decrease in the number of work site employees it provided PEO services to during the six months ended June 30, 2005 compared to the six months ended June 30, 2004. 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 six months ended June 30, 2005 and June 30, 2004.

| | Six months ended June 30, 2005 (Unaudited) |
|---|---|
| Reconciliation of billings to revenue recognized: | |
| Gross billings to clients | \$ 10,974,772 |
| Less - Gross wages billed to clients | (9,484,261) |
| | ----- |
| Total revenue as reported | \$ 1,490,511 ===== |

Cost of services for the six months ended June 30, 2005 was \$1,177,739 compared to cost of services of \$1,294,127 for the six months ended June 30, 2004 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, was \$1,500,434 for the six months ended June 30, 2005, compared to \$1,069,695 in the corresponding period of 2004. The increase was attributed to additional expenditures used to support the existing operations along with the cost to integrate the acquired RossarHR operation.

Sales and marketing expense was \$350,138 for the six months ended June 30, 2005, compared to \$145,197 in the corresponding period of 2004. The increase was attributed to the company's continued transformation of its sales and marketing function that began in the second quarter of

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2004.

Depreciation and amortization expense was \$29,920 for the six months ended June 30, 2005, compared to \$13,496 for the corresponding period of 2004. This increase was from the Human Resource Information System and various other office equipment placed in service in the third and fourth quarter of 2004.

Interest expense is interest paid and accrued on the Convertible Notes, unpaid payroll taxes, notes payable, and bank financing. Interest expense was \$232,708 for the six months ended June 30, 2005 compared to \$106,181 for the same period of 2004. The increase is primarily attributable to the continued use of financing for working capital.

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PACEL CORP. AND SUBSIDIARIES

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

Six Months ended June 30, 2005 compared to the Six Months ended June 30, 2004

Finance expense for the six months ended June 30, 2005 was \$362,143 compared to finance expense of \$1,355,714 for the six months ended June 30, 2004. The decrease was the result of reduced funding provided 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.

Three Months ended June 30, 2005 compared to the Three Months ended June 30, 2004

Revenue for the quarter ended June 30, 2005 was \$663,894 compared to revenue of \$866,238 for the quarter ended June 30, 2004. Revenues generated from the Rossar acquisition accounted for \$148,696 of the increase offset by a decrease of \$351,040 from the Company's existing clients.

The company experienced a decrease in the number of work site employees it provided PEO services to during the quarter ended June 30, 2005 compared to the quarter ended June 30, 2004. The company generates its revenue from services relating to work site employees. This decrease in work site employees was primarily from large construction and heavy industrial clients that terminated PEO services with the company for reasons ranging from plant and company closings to clients bringing the services typically offered in a PEO relationship in-house. The PEO industry as a whole has found it more difficult to provide the PEO services to construction and heavy industrial clients because of its inability to obtain workers compensation insurance. The company has focused its sales and marketing effort to white collar and light industrial clients where workers compensation insurance is readily and economically accessible.

Due to the significance of the amounts included in billings to the Company's clients and its corresponding revenue recognition methods, the Company has provided the following reconciliation of billings to revenue for the quarters ended June 30, 2005 and June 30, 2004.

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| | Three months ended June 30, 2005 (Unaudited) |
|---|---|
| | ----- |
| Reconciliation of billings to revenue recognized: | |
| Gross billings to clients | \$ 4,820,211 |
| Less - Gross wages billed to clients | (4,156,317) |
| | ----- |
| Total revenue as reported | \$ 663,894 |
| | ===== |

Cost of services for the three months ended June 30, 2005 was \$537,597 compared to cost of services of \$647,178 for the three months ended June 30, 2004 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, was \$686,887 for the three months ended June 30, 2005, compared to \$491,663 in the corresponding period of 2004. The increase was attributed to additional expenditures used to support the existing operations along with the cost to complete the integration of acquired RossarHR operation.

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PACEL CORP. AND SUBSIDIARIES

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

Sales and marketing expense was \$116,615 for the three months ended June 30, 2005, compared to \$58,831 in the corresponding period of 2004. 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 and amortization expense was \$15,476 for the three months ended June 30, 2005, compared to \$6,996 for the corresponding period of 2004. This increase was from the Human Resource Information System and various other office equipment placed in service in the third and fourth quarter of 2004.

Interest expense is interest paid and accrued on the Convertible Notes, unpaid payroll taxes, notes payable, and bank financing. Interest expense was \$130,908 for the three months ended June 30, 2005 compared to \$65,024 for the same period of 2004. The increase is primarily attributable to the carrying costs of unpaid liabilities and Convertible Notes.

Finance expense for the three months ended June 30, 2005 was \$101,643 compared to finance expense of \$1,110,714 for the three months ended June 30, 2004. The decrease was the result of reduced funding provided 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

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lines of credit.

LIQUIDITY AND CAPITAL RESOURCES:

Cash and cash equivalents at June 30, 2005 was \$550,386 compared to \$117,052 at December 31, 2004. The Company used cash from operations of \$1,083,303 and \$2,431,639 for the six months ended June 30, 2005 and June 30, 2004, respectively. The net loss of \$2,915,182 was offset by \$1,140,667 of non-cash items, the reductions in accounts receivable and payroll and payroll related liabilities, and the increases in accounts payable and accrued expenses.

Net cash provided by investing activities for the six months ended June 30, 2005 was \$689,532 compared to the net cash used in investing activities of \$704,137 for the six months ended June 30, 2004. During the six months ended June 30, 2005, the cash provided by investment activities was from the redemption of CD's (certificate of Deposits) used to secure 2 standby letters of credit issued in 2004, proceeds from the sale of assets, and the cash used in investing activities is attributable to computer equipment and software purchased for the company's business information. During the six months ended June 30, 2004, the cash used in investing activities is attributable to computer equipment and software purchased for the company's business information and an investment in a CD to secure a standby letter of credits.

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PACEL CORP. AND SUBSIDIARIES

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

Net cash provided by financing activities in the six months ended June 30, 2005 was \$827,105 compared to \$2,696,896 in the corresponding period ended June 30, 2004. The cash provided during both periods is primarily related to the Company's execution and utilization of its equity-based lines of credit.

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, The Escrow Corp, and T&B Associates, Inc. Borrowing from this equity line allows the repayment by issuing shares of the Company's stock at a discount rate of up to 50%. The line is being used to fund acquisitions and shortfalls in working capital. During the six months ended June 30, 2005, the Company drew down \$245,000 and issued 6,170,745,000 unrestricted shares of the Company's .001 par common stock, before adjusting such shares to reflect the effects of reverse stock splits occurring subsequent to issuance. After giving effect to the one-for-one thousand reverse split on February 28, 2005 and June 20, 2005, 970,950 shares were issued in conjunction with this equity line. The balance remaining on this equity line of credit at August 2, 2005 was \$2,249,102. The lenders are not obligated to fund the remaining balance on this equity line of credit and may discontinue funding the Company at any time without any further obligation.

During the second quarter of 2004, the Company entered into an agreement with a national bank to develop a program that eliminates the need for multiple banks. During the credit review process, the bank required the Company to secure its ACH (automated clearing house) exposure with a standby letter of credit. ACH transactions are used to collect funds due from the Company's clients for PEO services along with depositing funds into employee bank accounts that have elected

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direct deposit as a means of wage payment. The Company secured this standby letter of credit with an interest bearing CD (certificate of deposit) in the amount of \$600,000. In the first quarter of 2005, the Company reduced the standby letter of credit to \$500,000. In the second quarter of 2005, the Company entered into an agreement with another financial institution to process its ACH transaction thus allowing the Company to cancel this standby letter of credit and the CD.

During the second quarter of 2004, as part of the renewal process for one of its insurance carriers, the Company was required to secure the annual policy premiums with an irrevocable letters of credit in the amount of \$178,790. This irrevocable letters of credit was secured with an interest bearing CD's (certificate of deposits). During the second quarter of 2005, the Company elected to terminate this insurance policy thus allowing the Company to cancel this standby letter of credit and the CD.

In January 2005, the Company, through its wholly-owned subsidiary The Resourcing Solutions Group, Inc., completed the acquisition of certain assets of Rossar HR LLC, a Pennsylvania limited liability company, which operated under the name "Your Staff Solutions". Rossar HR LLC is a Professional Employment Organization founded in the 1987 which specializes in quality human resource management services for small to medium sized businesses. Consideration under such agreement did 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. The Company recorded the acquisition as a purchase and recorded \$52,000 of fees and \$232,950 of goodwill in association with this acquisition. The Company acquired assets consisting of office equipment and cash on hand totaling \$45,170 and assumes liabilities equal to \$6,100. During the first quarter of 2005, the Company recorded an impairment of \$131,950 reducing the value of goodwill to \$101,000.

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PACEL CORP. AND SUBSIDIARIES

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

The Company's cash requirements for funding its administrative and operating needs continue to greatly exceed its cash flows generated from operations. Such shortfalls and other capital needs continue to be satisfied through equity financing and convertible notes payable until additional funds can be generated through acquisitions and organic business growth. The liabilities of the Company consist of over-extended accounts payable, payroll taxes, and interest expense.

As part of its goal to bring the company to profitability and less reliant on equity financing for ongoing operations, the company has developed an aggressive marketing strategy as well as an investment to significantly upgrade its HRIS (Human Resource Information System) capabilities to service its current and prospective clients. 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 successfully negotiated joint marketing programs to market the company's products and services. 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 became fully operational in January 2005.

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In May 2005, The Resourcing Solutions Group, Inc. a subsidiary of the Company, sold 16 PEO accounts located primarily in North Carolina, South Carolina and Florida to Allegro, Inc. for \$122,055 and reported a loss of \$485,953. The Company will receive the \$122,055 over the next 12 months. Commensurate with the sale of the 16 accounts, the Company reorganized its operations. The Company reduced its internal staff, and other operating costs to the level necessary to serve the existing client base. The Company anticipates a future continued reduction in administrative costs as a result of this sale and the continued focusing of marketing efforts on the non-"blue-collar" industries. With the new HRIS system becoming operational the Company will be able to add additional clients without increasing its operational staff. The reorganization reduces the Company's heavy industry and "blue collar" client base allowing it to expand at a greater pace in other economic sectors which has been a stated goal of the Company. The targeted clients to which the Company is marketing its services have a greater capability to the more automated process integral to the new HRIS system. The reorganization also reduced the Company's reliance on outside equity funding.

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

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business; (e) uninsurable risks; and (f) general economic conditions.

Item 3. CONTROLS AND PROCEDURES.

As of June 30, 2005, an evaluation was performed under the supervision and with the participation of the Company's management, including the Principal Executive Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the Principal Executive Officer and the Principal Accounting Officer, concluded that the Company's disclosure controls and procedures were effective as of June 30, 2005. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to June 30, 2005.

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 former 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 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 and Calkins answered the second amended complaint on March 23, 2005. On April 7, 2005, a federal grand jury in the Northern District of Illinois returned an indictment charging Custable and ten other individuals and entities (The Company was not indicted) with engaging in a fraudulent scheme based on the same allegations as the SEC's action. On April 21, 2005, the District Court stayed the SEC's civil action pending resolution of the criminal action.

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PACEL CORP. AND SUBSIDIARIES

Item 6. Exhibits

| Exhibit No. | Description | Page |
|-------------|---|------|
| 3(i) | Articles of Incorporation | * |
| 3(ii) | Amendments to Articles of Incorporation | * |
| 4 | Designation of Series "B" Convertible Preferred Stock | * |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification | * |
| 32.1 | Section 1350 Certification | * |

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* Incorporation by reference from previous reports and filings.

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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

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Officer

DATED: August 19, 2005