PALLET MANAGEMENT SYSTEMS INC
Form 10-Q
May 11, 2001

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

FORM 10-Q

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

For the thirteen-week period ended
March 31, 2001
Commission File Number 000-24405

PALLET MANAGEMENT SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

Florida	59-2197020
(State or other jurisdiction of incorporation)	(IRS Employer Identification Number)

2855 University Drive, Suite 510, Coral Springs, Florida 33065
(Address of principal executive offices)

Registrant's telephone number, including area code:
(954) 340-1290
(Former name or address if changed since last report)

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 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 X No ___

On May 10, 2001, the Registrant had outstanding 4,065,612 shares of common stock, $.001 par value.

PALLET MANAGEMENT SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS

	March 31, 2001 (unaudited)
ASSETS	

CURRENT ASSETS	
Cash	$ 206,495
Accounts receivable - trade, net of allowance for doubtful accounts	$ 3,013,520
Inventories	$ 1,538,819
Other Current Assets	$ 320,498
Total current assets	$ 5,079,332
Property and equipment - net of accumulated depreciation	$ 5,781,817
OTHER ASSETS	
Vanderloo Pallet Machine - CIP	$ --
Palletnet - CIP	$ --
Other	$ 88,018
Total other assets	$ 88,018
Total assets	$ 10,949,167
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES	
Current maturities of long-term debt	$ 1,205,845
Current portion of capital lease obligations	$ 74,748
Accounts payable	$ 2,453,943
Accrued liabilities	$ 286,877
Total current liabilities	$ 4,021,413
LONG TERM DEBT	
Long-term debt	$ 3,666,468
Capital lease obligations	$ 136,167
Total long-term liabilities	$ 3,802,635
Total liabilities	$ 7,824,048
STOCKHOLDERS' EQUITY	
Preferred stock, authorized 7,500,000 shares at $.001 par Value; no shares issued and outstanding Common stock, authorized 10,000,000 shares at $.001 par value; issued and outstanding 4,065,612 shares at December 30, 2000 and June 24, 2000	$ 4,066
Additional paid in capital	$ 7,269,556
Accumulated deficit	$ (3,872,503)
Notes receivable from stockholders	$ (276,000)
Total stockholders' equity	$ 3,125,119
Total liabilities and stockholders' equity	$ 10,949,167

The accompanying notes are an integral part of these financial statements.

PALLET MANAGEMENT SYSTEMS, INC.
CONSOLIDATED STATEMENT OF OPERATIONS
(Unaudited)

	13 Weeks Ended March 31, 2001	13 Weeks Ended March 25, 2000
Net sales	$ 12,374,407	$ 14,155,057
Cost of goods sold	$ 11,593,615	$ 13,376,852
Gross profit	$ 780,792	$ 778,205
Selling, general and administrative expense	$ 802,917	$ 842,733
Operating profit (loss)	$ (22,125)	$ (64,528)
Other income (expense)		
Other income (expense)	$ 29,717	$ 6,301
Interest expense	$ (111,981)	$ (119,619)
Total other income (expense)	$ (82,264)	$ (113,318)
Income (loss) before income tax expense	$ (104,389)	$ (177,846)
Income tax expense (benefit)	$ --	$ --
Net income (loss)	$ (104,389)	$ (177,846)
Net earnings (loss) per common share	$ (0.03)	$ (0.04)
Diluted earnings (loss) per common share	*	*

* exercise of warrants and options would be anti-dilutive

The accompanying notes are an integral part of these financial statements.

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PALLET MANAGEMENT SYSTEMS, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)

	40 Wks End March 31, 2
Cash flows from operating activities:	
Net income (loss)	$ 206,6
Adjustments to reconcile net income (loss) to net cash provided by/(used in) operating activities:	

Depreciation	$ 386,1
Loss on disposal of assets and investments	$ 47,0
(Increase) Decrease in operating assets:	
Accounts receivable	$ 1,871,7
Inventories	$ 720,2
Other assets	$ 813,9
Increase (Decrease) in operating liabilities:	
Accounts payable	$ (306,2
Accrued liabilities,and current maturities of leases and debt	$ (503,0
Net cash provided by/(used in) operating activities	$ 3,236,5
Cash flows from investing activities:	
Other assets	$
Purchase of fixed assets	$(1,807,9
Net cash used in investing activities	$(1,807,9
Cash flows from financing activities:	
Net Borrowings from lenders	$ 1,031,2
Net Payments of long term debt	$(2,830,4
Net cash provided by/(used in) financing activities	$(1,799,1
Increase/(Decrease) in cash	$ (370,5
Cash at beginning of period	$ 577,0
Cash at end of period	$ 206,4

The accompanying notes are an integral part of these financial statements.

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Pallet Management Systems, Inc.
Notes to Financial Statements
March 31, 2001

Note 1. Consolidated Financial Statements:

The consolidated balance sheet as of March 31, 2001, the consolidated statements of operations and cash flows for the forty week period ended March 31, 2001 and thirty-nine week period ended March 25, 2000 and consolidated statements of operations for the thirteen week periods ending March 31, 2001 and March 25, 2000 have been prepared by the Company without audit in accordance with generally accepted accounting principles for interim financial information and with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the financial position, results of operations and cash flows for the periods reported have been made. Operating results for the forty weeks ended March 31, 2001 are not necessarily indicative of the results that may be expected for the year ended June 30, 2001. These consolidated financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's annual report filed on Form 10-KSB as of June 24, 2000.

Certain prior year amounts within the accompanying financial statements have been reclassified to conform to the current period presentation.

Note 2. Debt Agreement

The Company has a revolving loan and three term loans with La Salle Business Credit in a three year agreement, which commenced April 14, 2000. As of March 31, 2001 the Company was in full compliance with all loan covenants.

Advances under the revolving agreement are based on the sum of 85% of eligible accounts receivable, plus the lesser of 55% of eligible inventories or $2,500,000. Interest is paid monthly at the bank's prime rate. Principal is due in April 2003, with possible year to year renewals thereafter. The revolving agreement is collateralized by substantially all of the assets of the Company. At March 31, 2001, the Company had $ 2,450,000 of availability under the revolving agreement.

The three term loans as of March 31, 2001 were at $1,261,000, $1,583,000 and $1,031,000. These loans are collateralized by substantially all the assets of the Company.

Note 3. Inventories

Inventories consisted of the following at March 31, 2001:

Raw material	$ 885,524
Work in process	$ 381,330
Finished goods	$ 271,965
TOTAL	$ 1,538,819

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Note 4. Net Earnings (Loss) per Share of Common Stock:

Net earnings (loss) per share of common stock was determined by dividing net income (loss) applicable to common shares by the weighted average number of common shares outstanding during each period. Diluted earnings/(loss) per common share reflects the potential dilution that could occur assuming exercise of all issued and unexercised stock options. A reconciliation of the net income/(loss) and numbers of shares used in computing basic and diluted earnings/(loss) per common share is as follows (in thousands, except per share data):

	40 Weeks Ended March 31 2001	39 Weeks Ended March 25 2000
Basic earnings/(loss) per common share:		
Net income/(loss)	$ 207	($2,298)

Weighted average common shares outstanding for the period	4,065	3,955
Basic earnings per share of common stock	$ 0.05	($ 0.58)
Diluted earnings/(loss) per common share:		
Net income/(loss)	$ 207	($2,298)
Weighted average common shares outstanding for the period	4,065	3,955
Increase in shares which would result from exercise of stock options	256	*
Weighted average common shares, assuming conversion of the above securities	4,321	*
Diluted earnings/(loss) per share of common stock	$ 0.05	*

* exercise of warrants and options would be anti-dilutive

Note 5. Litigation

In June 1999, the Company was named as a co-defendant in a lawsuit whereby the plaintiff is alleging damages of up to $300,000 related to lost income from a facility and other property formerly leased to the Company in Jessup, Maryland. Management believes the claim is without merit and intends to vigorously contest the claim. St. Paul Insurance is currently paying defense costs. The outcome of the action as well as the extent of the Company's liability, if any, can not be determined at this time.

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Note 6. Revenue Recognition

Sales revenue is generally recorded upon the delivery of goods or the acceptance of goods by the customer according to contractual terms and represents amounts realized, net of discounts and allowances.

Note 7. Accounting for Software Related Costs

The Company accounts for the costs of computer software developed or obtained for internal use in accordance with Statement of Position 98-1 which generally requires the capitalization of costs incurred during the application development stage of computer software meeting certain characteristics. All costs incurred during the preliminary project stage and post implementation / operation stage are expensed as incurred.

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PART I

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

The following discussion and analysis should be read in conjunction with the financial statements appearing as Item 1 to this Report and the Form 10-KSB for the year ended June 24, 2000. The financial statements in this Report reflect the consolidated operations of Pallet Management Systems, Inc. (the "Company" or "Pallet Management") for the thirteen-week and forty-week periods ended March 31, 2001 and for the thirteen-week and thirty-nine week periods ended March 25, 2000.

The following discussion regarding Pallet Management and its business and operations contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act 1995. These statements consist of any statement other than a recitation of historical fact and can be identified by the use of forward-looking terminology such as "may," "expect," "anticipate," "estimate" or "continue" or the negative thereof or other variations thereon or comparable terminology. The reader is cautioned that all forward-looking statements are necessarily speculative and there are certain risks and uncertainties that could cause actual events or results to differ materially from those referred to in such forward looking statements, including the limited history of profitable operations, dependence on CHEP, competition, risks related to acquisitions, difficulties in managing growth, dependence on key personnel and other factors discussed under "Factors That May Affect Future Results" in the Annual Report on Form 10-KSB for the year ended June 24, 2000. Pallet Management does not have a policy of updating or revising forward-looking statements and thus it should not be assumed that silence by management of Pallet Management over time means that actual events are bearing out as estimated in such forward looking statements.

Results of Operations

General

Pallet Management has grown to be one of the largest pallet companies in the more than $6 billion North American pallet industry, by providing value-added products and services to its customers. Pallet Management has many customers which are Fortune 1000 companies, including Honeywell, CHEP, DuPont, IAMS, Mitsubishi, Monsanto, Scotts Company, and various governmental agencies.

The majority of our Company's revenues have traditionally been generated from providing high quality, specially engineered pallets to manufacturers, wholesalers and distributors. As supply chain logistics has become more complex, our existing customers as well as prospective customers are seeking new ways to streamline distribution and reduce costs, which is opening a huge service oriented market for our Company. With this shift in focus toward services and cost efficiency, our Company has started providing "state of the art" logistical services known as reverse distribution. Reverse distribution is simply defined as maximizing the use of transport packaging, the base of which is the pallet, by reusing assets to reduce the overall cost per trip. This shift in focus toward supply chain cost efficiency by our customer base is by far the most dramatic shift in focus and provides the most opportunity for our Company.

Our Company has two lines of revenue, manufacturing and services, with manufacturing currently accounting for 97% of the Company's net sales:

Manufacturing: We have two primary categories of manufacturing: CHEP grocery pallets and specially engineered niche market pallets. We have multi-year contracts to manufacture high quality pallets for CHEP, the world's largest pallet rental pool.

A significant portion of Pallet Management's current business is the sale of pallets and services to CHEP, which is part of the worldwide CHEP organization that manages the largest pallet rental pool worldwide, with more than 134 million pallets and over 20 million containers in 36 countries. CHEP services the retail, grocery and automotive industries with high quality pallets and containers. The Company focuses on non-standard, specialized packaging and does not compete with CHEP in its markets.

Pallets that are uniquely engineered to transport a specific product are classified as niche market pallets. Besides CHEP, our Company's customer base is primarily composed of customers who require niche pallets. These types of pallets are lower volume and higher margin than CHEP pallets.

Services: The Company provides three types of services: 1) Retrieval, sortation, repair, warehousing and return, 2) reverse distribution, and 3) other products.

First - Retrieval, sortation, repair, warehouse and return services enable our customers to better utilize their packaging assets. Besides being environmentally friendly, a properly repaired used pallet will provide the customer significant savings over having to buy a new pallet. Pallet users currently discard a large portion of new pallets after one use. The condition and size of these pallets vary greatly. The pallets are sorted and repaired as needed, placed in storage and made available for return to service. Pallets that can be repaired have their damaged boards replaced with salvaged boards or boards from new stock inventoried at the facility. Pallets that cannot be repaired are dismantled and the salvageable boards are recovered for use in repairing and building other pallets. Pallet Management sells the remaining damaged boards to be ground into wood fiber, which is used as landscaping mulch, fuel, animal bedding, gardening material and other items. Despite recent increases in levels of automation, pallet return operations remains a labor-intensive process.

Second - Reverse distribution can carry the retrieval, sort, repair, warehouse, and return services one step further by contracting with a customer to manage, track and provide valuable management information related to their pallet flow. As part of the Company's strategy to use the Internet to improve the functionality of its service offerings, it developed PalletNetTM . PalletNet is a service brand providing a logistics and information system that manages the flow of shipping platforms and containers throughout industrial supply chains (excluding the grocery industry). The principal services PalletNet offers include reverse distribution, single source national contracts, high quality shipping platforms and transport packaging, recovery, repair, recycling and export packaging. These physical activities are supported by leading edge technology that enables users to improve shipping asset controls and reduce cost and waste from the supply chain, while improving inventories and enhancing customer satisfaction. By coupling PalletNet with the Internet, the Company is creating value for the customer through lower costs and improved efficiencies. The PalletNet e-portal is a browser-based user interface combined with three levels of security management which delivers unlimited, safe access to customers who can view exactly where their shipping platforms and containers are in the supply chain at any given moment. The system also offers a full range of personalization options, so each company can configure PalletNet to their operations. In addition, PalletNet has the capacity to use either bar codes or radio frequency identification tags to track individual pallets and the equipment transported on them. These new, "state of the art", logistics and information system capabilities provide customers and Pallet Management the technical support requirements to manage an efficient reverse distribution operation and management of valuable transport packaging from any location in which they can access the Internet.

Third - Pallet Management functions as a wholesale distributor of other various returnable transport packaging such as plastic and metal pallets; collapsible plastic bulk boxes; wood, plastic, and metal slave pallets; wooden boxes and crates; and various other products. Due to lack of demand, sales of pallets made from materials other than wood are minimal.

In order to fulfill the increasing demand for transport management services, Pallet Management plans to expand its service offerings and service revenues by hiring additional key sales personnel during this fiscal year. Though expanding sales of services will not require any significant capital expenditures, it will increase SG&A as a percentage of sales until newly hired sales personnel are trained. In addition, the cycle for completing a sale of services is significantly longer than that for selling manufactured pallets. We anticipate that service will become a greater percent of net sales as we expand our sales personnel.

Thirteen Weeks Ended March 31, 2001 compared to Thirteen Weeks Ended March 25, 2000

For the thirteen-week period ended March 31, 2001, net sales decreased 13% to $ 12,374,000 from $14,155,000 for the comparable fiscal year 2000 period. This decrease is due to reduced demand for new pallets as well as services.

During the thirteen-week period ended March 31, 2001, manufacturing sales decreased 11% to $ 12,011,000 from $13,507,000. The decrease in manufacturing sales was primarily due to the reduction of orders received by our major customer at our Alabama, Indiana and Illinois facilities, as well as a general slow down of orders received in the niche pallet sales at the Lawrenceville, Virginia location.

Service sales decreased by 44% to $363,000 from $ 648,000. This decrease in service sales is primarily due to the reduction of repair services made at the Petersburg, Virginia facility as a result of reduced demand from the facility's key customer.

Pallet Management had a 5% reduction in its selling, general and administrative expenses from $ 843,000 to $ 803,000 for the thirteen week period ended March 31, 2001 when compared to the thirteen week period ended March 25, 2000. The selling, general and administrative expenses were reduced based on management initiative to hold down costs during the reduced order period as well as the elimination of a level of management.

A loss of ($104,000) or ($.03) per share was realized during this thirteen-week period ended March 31, 2001 compared to a net loss of ($178,000) or ($.04) per share recorded for the thirteen-week period last fiscal year. Compared to the same period last year, we were able to reduce the losses on less sales due to operational and management improvements, as well as cash flow management improvements. Management has successfully concentrated its efforts on reducing variable and semi-variable costs when order demands slow down. Pallet Management anticipated this third quarter slow down at the end of the previous quarter and made necessary adjustments to its staffing and production requirements. In addition, losses were also experienced as pine lumber prices dramatically decreased to historically low levels thus decreasing our inventory valuation and making pallet component production for our other assembly facilities uneconomical. This resulted in lost cost savings during the decreased market for lumber.

Forty Weeks Ended March 31, 2001 compared to Thirty-nine Weeks Ended March 25, 2000

For the forty-week period ended March 31, 2001, net sales increased 21% to $ 53,458,000 from $ 44,250,000 for the thirty-nine week period ended March 25, 2000.

During the forty-week period ended March 31, 2001, manufacturing sales increased 27% to $ 51,997,000 from $ 40,873,000 for the thirty-nine week period ended March 25, 2000. The increase in manufacturing sales was primarily due to the opening of two new facilities during fiscal year 2000. The impact of those two facilities can be seen in the six month period ended December 2000. The current thirteen-week period shows a decrease from the same period the year before primarily due to the reduction of orders in all four of the manufacturing facilities.

Service sales decreased by 57% to $ 1,461,000 from the $3,377,000 recorded for the thirty-nine week period ended March 25, 2000. The decrease in services is primarily due to the closing of the Lakeland service facility in December 1999 when the facility's major customer opened its own facility near-by. Another contributing factor to reduced service sales was the reduction of repair services made at the Petersburg, Virginia facility as a result of reduced demand from the facility's key customer.

We experienced an 11% decrease in selling, general and administrative expenses from $ 3,371,000 to $ 3,006,000 for the forty-week period ended March 31, 2001 when compared to the thirty-nine week period ended March 25, 2000. This decrease was a result of additional management costs related to the sales volume increase and expenses related to expanding our reverse distribution business during the thirty-nine week period ended March 25, 2000. During the forty-week period ended March 31, 2001, management was reorganized and these additional costs have now been addressed and streamlined as we improved our operational structure. Additionally, during the forty-week period ending March 31, 2001, we incurred less expenses due to the closing of two administrative facilities in 1999.

A net income of $ 207,000 or $0.05 per share was realized during this forty-week period ended March 31, 2001 compared to a net loss of ($2,298,000) or ($0.58) per share recorded for the thirty-nine week period ended March 25, 2000. During the thirty-nine week period ended March 25, 2000 management positions were eliminated and substantial charges were incurred totaling $690,000. Costs included in selling, general and administrative expenses consisted of $32,000 for legal and accounting expenses related to a postponed equity offering and The Nelson Company transaction, $67,000 for closing the Cary, North Carolina and Richmond, Virginia offices and $192,000 for custom software which is outdated and no longer used. Costs included in cost of goods sold consisted of $77,000 for equipment at the Bolingbrook, Illinois facility that is not economically efficient and no longer used and $250,000 related to the closing of the Lakeland, Florida facility. During the forty-week period ended March 31, 2001, we have increased sales, streamlined our costs within our manufacturing plants, and hired new management to spearhead our goals toward profitability. By anticipating and planning for the reductions to the order rate, Pallet was able to maintain its profitability on a year-to-date basis. During the beginning of the fourth quarter, Pallet Management Systems has experienced an increase in demand and sales.

Liquidity and Capital Resources

Pallet Management Systems had $206,000 cash on hand at March 31, 2001, versus $577,000 at the beginning of the fiscal year. The decrease in cash is primarily attributed to the use of $1,799,000 in investing activities for the purchase of our Vanderloo Nailing Machine in Indiana and the capitalization of our Palletnet software costs netting a change of $ 1,808,000, which was offset by $3,237,000 generated from operating activities. The cash used in financing activities is primarily due to repayments on the revolver and term loans to LaSalle Business Credit ($2,830,000) offset by additions to our capital line and other financed activities of $1,031,000. The repayment of the revolver to gain a lower average outstanding balance was caused by utilizing a zero balance account and only funding the revolving loan when payables were presented to the bank. This resulted in a decrease in interest expense estimated at $125,000 annually.

The $ 3,237,000 in cash generated from operating activities is primarily due to accounts receivable decreasing over the forty week period ended March 31, 2001 by $ 1,872,000, the decrease to inventory levels of $ 720,000, the capitalization of the Vanderloo Machine from construction in progress, and the fiscal year to date net income of $ 207,000. The decrease in outstanding accounts receivable is caused by the more timely customer payments for the forty-week period ending March 31, 2001 along with the decreased receivables from our major customer which accompanied the lower order rate. The Company decreased its borrowings from LaSalle Business Credit by $ 1,799,000 over the forty-week period ended March 31, 2001. This decrease was made up of a reduced revolver borrowing base plus principal payments on our term loans of $2,830,000 born from effective cash management offset by the addition to the capital loan for a portion of the Vanderloo Nailing Machine of $1,031,000. During the forty-week period ended March 31, 2001, we capitalized costs primarily associated with the Vanderloo Nailing Machine, which was put into production at our Indiana facility, and these assets were capitalized for $1,421,000.

The Company believes that existing cash on hand, cash provided by future operations including PalletNet services, additional available borrowings under its current line of credit, and a net working capital of $ 1,058,000 as of March 31, 2001, will be sufficient to finance its operations and expected working capital and capital expenditure requirements for at least the next twelve months. The Company expects the order trend to pick back up in the thirteen-week period ended June 30, 2001.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In June 1999, the Company was named as a co-defendant in a lawsuit whereby the plaintiff is alleging damages of up to $300,000 related to lost income from a facility and other property formerly leased to the Company in Jessup, Maryland. Management believes the claim is without merit and intends to vigorously contest the claim. St. Paul Insurance is currently paying defense costs. The outcome of the action as well as the extent of the Company's liability, if any, can not be determined at this time.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

PALLET MANAGEMENT SYSTEMS, INC.

Dated: May 11, 2001 By: /s/ Zachary M. Richardson

Zachary M. Richardson, President

Dated: May 11, 2001 By: / s/ Marc. S. Steinberg

Marc S. Steinberg, Treasurer, Vice President of Finance and Secretary (Principal Financial and Accounting Officer)