PALLET MANAGEMENT SYSTEMS INC
Form 10-K/A
October 22, 2002

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

FORM 10-K/A1

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

For the fiscal year ended June 29, 2002

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 or Organization)	(I.R.S. Employer Identification Number)
2855 University Drive, Suite 510 Coral Springs, Florida	33065
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: (954) 340-1290

Securities registered pursuant to Section12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock

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 days.

Yes X No ___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Company is $551,378 based on the closing price of $ 0.23 per share as of September 27, 2002.

As of September 27, 2002, there were 3,996,612 shares of the registrant's common stock outstanding.

Documents Incorporated by Reference:

None.

PART II

Item 6. Selected Financial Data

	Fiscal Years End		
	29-Jun-02	30-Jun-01	24-Jun-00
Net Sales	$ 47,799,439	$ 72,167,233	$ 62,445,175
Income (loss) from continuing operations	$ (1,144,424)	$ 302,984	$ (2,249,967)
Income (loss) from continuing operations per share	$ (0.28)	$ 0.07	$ (0.57)
Total Assets	$ 9,895,246	$ 12,879,737	$ 13,350,996
Long-term debt	$ 4,072,936	$ 5,576,663	$ 5,597,490
Cash dividends per share	$ --	$ --	$ --

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

Fifty-third Week in Fiscal Year 2001

Comparisons of fiscal year 2002 to fiscal year 2001 are affected by an additional week of results in fiscal 2001. Because our fiscal year ends on the last Saturday in June, a fifty-third week is added every 5 or 6 years. The fifty-third week increased 2001 net sales by an estimated $1.3 million and net income by an estimated $6 thousand.

Cautionary Statements

The following discussion and analysis should be read in conjunction with Pallet Management's Consolidated Financial Statements and the Notes thereto included in Part II, Item 8 of this Report.

The following discussion regarding Pallet Management and its business and operations contains "forward-looking statements" within the meaning of Private Securities Litigation Reform Act 1995. These statements consist of any statements 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 a key customer, competition, risks related to acquisitions, difficulties in managing growth, dependence on key personnel and other risk factors discussed in this report. See "Risk Factors." 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 the Pallet Management over time means that actual events are bearing out as estimated in such forward looking statements.

Results of Operations

General

The majority of our revenues have traditionally been generated from providing high quality, specially engineered pallets to manufacturers, wholesalers and distributors. As supply chain logistics have become increasingly 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-orientated market for the Company.

With this shift in focus toward services and cost efficiency, we are offering "state of the art" logistical services known as "Reverse Distribution". Reverse Distribution involves 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 efficiency by our customer base is by far our industry's most dramatic shift in focus and provides the most opportunity for our Company. Driven mainly by economics, reusable packaging in a Reverse Distribution system also has environmental benefits.

As this market of Reverse Distribution is just starting to be created, the economic advantages to companies that are implementing it are huge. We are working diligently as an industry leader in this area, as the growth potential continues to unfold.

Reverse logistics, a sub-industry of the logistics industry, is growing rapidly and is estimated to have reached $7.7 billion. The third-party logistics industry is estimated to be in excess of $35 billion and growing rapidly as companies are discovering the benefits of outsourcing their logistical demands.

The Company has two lines of revenue, manufacturing and services:

Manufacturing: Our Company has two primary categories of manufacturing: CHEP grocery pallets and specifically engineered niche market pallets. The Company has a contract to manufacture high quality grocery pallets for CHEP, the world's largest pallet rental pool. The Company has one manufacturing facility currently producing CHEP pallets.

Pallets that are specially 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. Niche pallets are lower volume and higher margin than CHEP pallets.

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

Services: Our Company provides a variety of retrieval, sortation, repair, warehouse and return services that 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. Despite recent increases in levels of automation, pallet return operations remain a labor-intensive process.

Companies currently discard a large portion of new pallets after one use. The condition and size of these pallets vary greatly. The pallets are retrieved, 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.

As part of the Company's strategy to use the Internet to improve the effectiveness of its service offerings, it developed PalletNetTM, 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). PalletNetTM creates a closed loop delivery, recovery and recycling system, which enables customers to treat pallets as assets rather than expendables. The principal services PalletNetTM 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 control and reduce cost and waste from the supply chain, while also reducing inventories and enhancing customer satisfaction.

By coupling PalletNetTM with the Internet, the Company is creating value for the customer through substantially lower costs and improved efficiencies. The PalletNetTM Application 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 is also designed to be easily customizable, so each company can configure PalletNetTM to their specific operations. In addition, PalletNetTM has the capacity to use either bar codes or radio frequency identification (RFID) tags to track individual pallets and the equipment transported on them. These new, "state of the art" tracking, logistics and information system capabilities provide customers and Pallet Management the technical support needed to manage an efficient Reverse Distribution operation and valuable transport packaging from any location where Internet access is available.

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 progress in our marketing and sales effort within this area.

Discussion of fiscal year 2002

Fiscal year 2002 saw many changes within our Company. Two manufacturing contracts with our largest customer in Alabama and Illinois were not renewed. Compared to fiscal year 2001, the impact of those two contracts within the fiscal year was a reduction in revenue of $20.4 million. The equipment for both of those facilities was moved primarily to our Indiana facility to increase that plant's production capacity for CHEP or other customers. Additionally, the

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decline in business experienced by our Lawrenceville, Virginia facility, which began in January 2001, continued until February 2002. That decline was caused primarily by general economic conditions and negatively impacted sales during fiscal year 2002 as compared with fiscal year 2001 by $3.4 million.

During March, the Company terminated its President, who, pursuant to the request of the Company's Board of Directors, had relinquished executive authority on behalf of the Company on January 23, 2002. The Company's Board of Directors at that time appointed Robert Steiler, one of its members, to be the Company's interim leader of its executive management. Numerous cost cutting measures were implemented, and the Company reduced expenditures by over $1,000,000 annually. The Company began an aggressive marketing campaign in March 2002, including a new brochure, media advertising and other marketing materials, and began a direct mail campaign offering incentives to win new customers and bring others more strongly into the fold.

As the fiscal year came to a close we experienced a continued increase in the order rate into our Virginia facility, as well as strong orders from our largest customer for our Indiana facility

Our current management team continues to recognize the dependency on a single customer and is taking steps to expand our customer base for niche pallets and PalletNetTM services. We are continuing with an aggressive marketing campaign and are beginning implementation of our PalletNetTM Asset Tracking System.

June 29, 2002 vs. June 30, 2001

For the year ended June 29, 2002, net sales decreased 34% to $47,799,439 from $72,167,233 for the prior year. This decrease was due mainly to the closings of the Alabama and Illinois facilities, which serviced one main customer. The decrease in sales from these two facilities were $20.4 million in fiscal 2002 as compared with fiscal 2001. Additionally, the decline in business experienced by our Lawrenceville, Virginia facility, which began in January 2001 continued until February 2002. That decline was caused primarily by soft general economic conditions and negatively impacted sales during fiscal year 2002 as compared with fiscal year 2001 by $3.4 million. Sales other than new pallet sales, comprised principally of service, accounted for 3% of net revenues, as opposed to 4% of net revenues the previous year. These sales dropped from approximately $2,047,000 in fiscal year 2001 to approximately $1,887,000 in fiscal year 2001. The decrease is primarily due to a slightly reduced demand from that facility's main customer.

Cost of sales for 2002 was $44,810,597 or 93.7% of net sales, as compared to $67,035,408 or 92.9% of net sales for 2001. This increase in cost of sales in relation to net sales, is primarily due to the mix in sales and still reflects the more efficient operations that were achieved in production throughout fiscal year 2001. In addition, we continued to focus on cost control as production slowed in two facilities (Alabama in the beginning of the fiscal year and Illinois at the beginning of the third fiscal quarter) and reduced spending. Efficiencies were maintained in the plants by controlling machine down time and improved production planning during periods of reduced demand.

Selling, general and administrative expenses were $3,681,120 or 7.7% of net sales in 2002, as compared to $4,320,719 or 6.0% of net sales in 2001. This increase is primarily due to decreased sales volume in Alabama and Illinois with a lag in corresponding decreases in costs. Reductions were made in many areas including travel, entertainment, legal and salaries to offset the decrease in revenues, however, we incurred runoff expenses as these operations wound down

inclusive of salaries, severance payments and rent/utilities without production and sales. Additionally, the Company has not put its nailing machine from the Alabama facility into service since the latter plant's closure. The nailing machine has not been used in over 12 months and is sitting idle in the Company's Indiana facility. The Company took an impairment write down of $154,740 on this machine as of June 29, 2002. Customers are still being sought for production utilizing this machine, but it appeared unlikely that the asset costs would have been recovered at its then net book value and therefore, the write down was required. Our corporate structure during the year became more streamlined as we reduced headcount to offset the decreased revenues associated with these plant closings.

Net interest expense decreased to $379,864 in 2002 from $528,078 in 2001. This decrease came as a result of both reductions to the prime interest rate and reductions in our loan amounts. We no longer borrowed against inventories in Alabama and Illinois (plant closings), which reduced our average debt. Additionally, a tight focus on cash management allowed the Company to reduce its net borrowings on an ongoing basis.

Net losses for 2002 were $1,144,424 compared to a net income of $302,984 in 2001. This difference of over $1.4 million is primarily due to reductions in sales from our Alabama and Illinois plants which closed during fiscal year 2002. The reduction in gross sales from those two facilities totaled $20.4 million. The Company also saw declining sales out of the Lawrenceville, Virginia facility by $3.4 million from the prior year due to poor economic conditions. The Company reacted to the facility closures by reducing costs in the second half of the year. The impact of those reductions will not be felt until fiscal year 2003 due to the timing of those reductions as some included run-off costs through May and June (severance payments, rent, and contractual obligations).

June 30, 2001 vs. June 24, 2000

For the year ended June 30, 2001, net sales increased 16% to $72,167,233 from $62,445,175 for the prior year. This increase was due mainly to an increase in new pallet sales, which accounted for 97% of net revenues, as opposed to 92% of net revenues the previous year. New pallet sales increased due to sales to one customer, which accounted for 86% of our sales. Sales other than new pallet sales, comprised principally of service, accounted for 3% of net revenues, as opposed to 8% of net revenues the previous year. These sales dropped from approximately $4,996,000 in fiscal year 2000 to approximately $2,047,000 in fiscal year 2001. The decrease is a result of closing the Lakeland facility in fiscal year 2000, and a reduction in the order rate on services experienced in our third quarter.

Cost of sales for 2001 was $67,035,408 or 93% of net sales, as compared to $59,097,842 or 95% of net sales for 2000. This decrease in cost of sales in relation to net sales, is due to becoming more efficient in production throughout fiscal year 2001. In addition, we focused on cost control and reduced spending. Efficiencies were gained in the plants by reducing machine down time and by planning production during periods of reduced demand. By leveling our production, we held down additional costs in our facilities and contributed to the cost of sales percent decrease noted above. By decreasing down time, we were able to produce more product without adding additional labor costs, which also reduced our cost per unit.

Selling, general and administrative expenses were $4,320,719 or 6.0% of net sales in 2001, as compared to $4,899,091 or 7.8% of net sales in 2000. This decrease is primarily due to increased sales volume and cost control. Reductions were made in many areas including travel, entertainment and legal expenses and

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salaries. Our corporate structure during the year became more streamlined as we set our management team in place and focused on putting controls in place while developing new sales opportunities.

Net interest expense decreased to $528,078 in 2001 from $545,119 in 2000. This decrease came as a result of improved cash management. We changed our approach on borrowing from our revolver loan to reduce the average outstanding balance on a daily basis. We borrowed $1,031,000 in fiscal year 2001 for our new Vanderloo nailing machine, which was installed in our Plainfield, Indiana facility. By increasing our borrowings, we incurred more interest expense, which offset the savings realized from our improved cash management policies and procedures. Additionally, we were helped during the year by declining interest rates that contributed to reduce expenses.

Net income for 2001 was $302,984 compared to a net loss of $2,249,967 in 2000. This was an improvement of over $2.5 million and signified a turnaround to profitability. During 2001 manufacturing operations made many improvements which led to our profitable year. Among those improvements were significant reductions to machine downtime, process engineering to eliminate costs from our manufacturing lines and reductions in staffing where appropriate. During November we began planning for a slow down from our major customer in January. We were prepared for and minimized losses during a slow third quarter and when sales started coming back up in April, we were prepared to meet all of our customer expectations.

The month of May saw the largest increase to pine lumber prices in recent history of nearly 30% and contributed greatly to losses during that month as we could not pass this cost increase on to our customers. We continued to meet our customer demands and worked with our vendors on gaining price reductions to counteract the May pine lumber price increases seen in May so that our profitability for June would be maximized. During the course of this fiscal year, we reorganized the business structure of the company by creating distinct departments, which had clear lines of responsibility and authority. We also hired a completely new senior management team. During the transition of reorganizing, we relied upon outside consultants to fill some senior management positions until the new management team was in place. Consultants were utilized primarily for manufacturing operations, human resources, marketing, materials, systems and logistics. The company expects to reduce expenditures on consultants materially during fiscal year 2002. The total expenditures made during the course of fiscal year 2001 for these consultants were $515,000.

Liquidity and Capital Resources

We had $72,561 of cash on hand at June 29, 2002, compared to $232,635 at the beginning of fiscal year 2002. Net cash provided from operating activities was $845,014 for the year. We decreased our account receivables by approximately $1,086,000 and our inventories by approximately $943,000 during the fiscal year. The account receivables decreased as a result of improved collections, and the reduction of sales due to two plant closings in fiscal year ending June 2002. The inventories were reduced primarily due to the two plant closings and the effort to reduce our on-hand balances and increase our turns to generate effective uses of cash.

Our debt servicing with LaSalle Business Credit, Inc. remained consistent with prior years. We both reduced our loan principal with timely payments and continued to reduce our revolving loan down. We decreased our

borrowings from LaSalle Business Credit, Inc. by $ 799,500 during the fiscal year ended June 29, 2002. This decrease was made up of a reduced revolver borrowing base (plant closings) of $211,500 plus principal payments on our term and real estate loans of $588,000.

In the first, third and fourth quarters of fiscal of fiscal 2002, the Company did not meet its covenants with LaSalle Business Credit, Inc. Although LaSalle Business Credit, Inc., gave us waivers, it also increased our borrowing interest rate to prime plus 2%. Due to the Company's performance in the fourth quarter of fiscal 2002, it is likely that the reset covenants would be met by the end of the first quarter in fiscal 2003. The Company can not predict how LaSalle Business Credit, Inc. will react to covenant violations in the future.

Pallet Management intends to pursue expansion and acquisition plans, which may include the opening of additional facilities as well as the acquisition of additional facilities or companies. The success and timing of any such plans and required capital expenditures for them cannot be reasonably estimated at this time and the Company has no current arrangements with respect to any such acquisition or expansion. Funding for these plans and for ongoing operations could be a combination of issuance of additional equity, working capital, additional borrowings, and profits from operations. Pallet Management cannot make any assurances that such funding would become available for such plans.

Management believes that existing cash on hand, cash provided by future operations and services, additional borrowings under its current line of credit, and a net working capital of $1,303,000 as of June 29, 2002, may not be sufficient to finance its operations, expected working capital and capital expenditure requirements for the next twelve months. To have sufficient capital, an increase in the order rate in the Lawrenceville, Virginia operation needs to occur at a level twice that experienced in fiscal 2002, and continued, consistent ordering, with or without a contract renewal/extension with CHEP, needs to happen from them. If this does not occur, the Company may not be able to meet its obligations without additional financing during fiscal year 2003.

Risk Factors

Limited History of Profitable Operations

The Company reported a net loss of $1,144,424 for the fiscal year ended June 29, 2002, a net income of $302,984 for the fiscal year ended June 30, 2001, a net loss of $2,249,967 for the fiscal year ended June 24, 2000, a net income of $537,529 for the fiscal year ended June 26, 1999, and a net income of $191,627 for the fiscal year ended June 27, 1998. The Company cannot guarantee that it will be profitable or that it will sustain growth. The Company cannot guarantee that it will sustain or increase profitability on a quarterly or annual basis in the future.

Dependence on Key Customer

The Company currently depends on CHEP for a material portion of its business. During the fiscal year ended June 29, 2002 and for the fiscal year ended June 30, 2001, approximately 86% of the Company's revenues and a significant percentage of its growth were attributable to CHEP. The Company expects that the revenues from CHEP may account for up to 80% of its revenues and will continue to be a material portion of its business for the next fiscal year until the Company can diversify its customer base. In addition, CHEP is the predominant customer of certain of the Company's facilities. If CHEP were to materially decrease its purchase of pallets from the Company, the Company's

financial condition and results of operations would be materially adversely affected. The Company has an agreement with CHEP for its Plainfield, Indiana facility to perform CHEP pallet manufacturing. The repair and depot services provided out of the Petersburg, Virginia facility are not under contract and could end with 120 day notice, although this would not significantly impact the profitability of the Company. The Company has been notified by CHEP that the existing Indiana agreement will not be renewed on March 1, 2003. The Company is currently negotiating a new agreement for its Plainfield, Indiana location, but can not guarantee that this contract will be concluded prior to the expiration of the original contract.

Supply and Demand for Lumber

Pallet prices are closely related to the market price of lumber, the principal raw material used in the manufacture and repair of wooden pallets. If lumber prices increase sharply, the Company may not be able to pass this increase on to its customers. The Company has attempted to index the sale prices of its pallets based on its lumber costs, although the Company has not always been able to do so.

The price of lumber has been volatile in recent years due to factors beyond the Company's control, including:

- weather and other natural events;
- governmental regulation of logging on public lands;
- lumber agreements between Canada and the U.S.; and
- competition from other industries that use similar grades and types of lumber.

Although the Company typically buys its lumber in the open market, the Company purchased approximately 44% of its lumber from 3 suppliers in fiscal 2002. However, the Company might be unable to purchase adequate lumber supplies to meet its needs. To the extent the Company encounters adverse lumber prices or is unable to procure adequate supplies of lumber, the Company's financial condition and results of operations could be materially adversely affected. The Company purchased approximately 4.2% of its lumber from a related company, Clary Lumber Company, Inc., a North Carolina corporation. See Item 13, "Certain Relationships and Related Transactions."

Competition from Other Companies

There are over 3,600 companies that manufacture pallets or provide pallet recycling services. Many of these are small companies that concentrate on the grocery and retail businesses in which the Company does not generally compete, although they might at any time attempt to compete directly with the Company. The Company generally services specialty markets and other services in which there are not as many competitors. CHEP's pallet rental system competes with new pallet sales to the grocery and wholesale distribution industries, and may expand into other industries in the future.

Pallet manufacturing and recycling operations are not highly capital intensive, and the barriers to entry in these businesses are minimal. Smaller competitors might have lower overhead costs and consequently, may be able to manufacture or recycle pallets at lower costs than the Company. Other companies

with significantly greater capital and other resources than the Company (including CHEP) might enter or expand their operations in the pallet manufacturing and recycling businesses in the future, which could change the competitive dynamics of the industry.

Potential Increase in Debt and Interest Expense and Financing

On March 31, 2000, the Company established a $9,609,000 borrowing facility with LaSalle Business Credit, Inc., of which approximately $4,880,000 was outstanding as of June 29, 2002.

The Company uses the borrowing facility to finance receivables, inventory, and real estate as well as for various other corporate purposes including the purchase of new equipment. Thus, the Company's debt and interest expense may be substantially higher in the future, which could limit the Company's flexibility. In addition, this bank has a lien on substantially all of the Company's assets.

During fiscal year 2002, the Company did not pass the Consolidated Debt Service Coverage Ratio for the thirteen weeks ending September 29, 2001, the Company did not pass the Consolidated Tangible Net Worth, the Consolidated Interest Coverage Ratio or the Consolidated Debt Service Coverage Ratio for the thirty-nine week period ending March 30, 2002 and the Company did not pass the Tangible Net Worth covenant for the period ending June 29, 2002. The Company has received waivers for these covenant violations. LaSalle Business Credit raised our interest rate to prime plus 2% on all of our outstanding loans when the waivers were granted.

Should the Company not meet its reset covenants for fiscal 2003, LaSalle Business Credit may not renew our loan which comes due in October, 2003 and could seek liquidation of our assets to satisfy our loan if we are unable to secure new financing. If interest rates were raised by 100 basis points, given our outstanding debt, the additional interest expense would be approximately $50,000

Potential Risks Related to Acquisitions

One of the Company's growth strategies is to acquire additional pallet manufacturing and recycling companies to increase the Company's revenues and markets. Acquisitions involve a number of risks, including:

- adverse short-term effects on the Company's operating results;
- difficulties in successfully integrating and managing

additional businesses;
- diversion of management's attention;
- dependence on retention, hiring and training of key personnel;
- loss of existing or anticipated customers of the acquired companies;
- unanticipated problems or legal liabilities; and
- amortization of acquired intangible assets.

Some or all of these risks could have a material adverse effect on the Company's financial condition or results of operations. In addition, to the extent that consolidation becomes more prevalent in the industry, the prices for attractive acquisition candidates might increase and the number of attractive acquisition candidates might decrease. The Company cannot guarantee that it will be able to acquire additional businesses or successfully integrate and manage such additional businesses.

Potential Problems in Financing Acquisitions

The Company might potentially issue additional shares of its Common Stock as partial consideration for future acquisitions. If the Common Stock does not maintain a sufficient valuation or potential acquisition candidates are unwilling to accept Common Stock as part of the consideration for the sale of their businesses, the Company might be required to use more cash or bank financing, if available, in order to complete acquisitions. If the Company does not have sufficient cash resources or borrowing availability, the Company's growth could be limited unless the Company is able to obtain additional capital through future debt or equity financing. The Company does not currently have sufficient availability under its current facility to finance any additional acquisitions. Using cash to complete acquisitions and finance internal growth could substantially limit the Company's financial flexibility. Using debt could result in financial covenants that limit the Company's operations and financial flexibility. The Company might be unable to obtain financing if and when needed on acceptable terms. As a result, the Company might be unable to pursue its acquisition strategy successfully.

Transactions With Affiliates

For fiscal 2002, the Company purchased approximately $1,539,000 or 4%, as compared to $2,455,000 or 4% for fiscal 2001, of its lumber supply from Clary Lumber Company, Inc., a North Carolina corporation ("Clary"), which is owned by the family of John C. Lucy, Jr., a principal shareholder and former Director of Pallet Management. John C. Lucy, III, Mr. Lucy's son, is Pallet Management's Chief Executive Officer and is also President and a minority shareholder of Clary. The Company closely monitors these transactions and believes that these transactions were, and are, made at prices comparable to vendors other than Clary in the ordinary course of business.

Volatility of Stock Price

The trading price of the Company's Common Stock has been, and in the future is expected to be, volatile. The Company may experience further market fluctuations as a result of a number of factors, including:

- current and anticipated results of operations;
- changes in the Company's business, operations or financial results;
- general market and economic conditions;
- competition;
- the low number of shares outstanding;

- low trading volume;
- the number of market makers in the Company's stock; and
- other factors.

Difficulties in Obtaining New Sales

In the last year, the Company has brought in key personnel to sustain current sales and focus on new sales. New sales will be required to sustain current operations in all of our facilities. Should the Company not be able to obtain adequate new sales we might be unable to:

- successfully implement its business and marketing strategy;
- generate sufficient cash flow from operations;

- manage its costs; and
- successfully manage continued growth.

The failure to obtain new sales might have a material adverse effect on the Company's business, financial condition and results of operations.

Dependence on Key Personnel

The Company materially depends upon the services of the following individuals:

- John C. Lucy, III, Chief Executive Officer
- Marc Steinberg, Chief Financial Officer, Secretary and Treasurer
- Ellen Chambers, Director of Information Technologies

The Company has a five-year employment agreement with Mr. Lucy that expires October 2003. In addition, the Company currently has Key-man insurance in the amount of $1,000,000 on Mr. Lucy. The Company would be adversely affected by the loss of the services of any of the above-mentioned individuals.

No Dividend Payments

The Company has never paid any cash dividends on its Common Stock and does not anticipate paying cash dividends on its Common Stock in the foreseeable future. The future payment of dividends is directly dependent upon the Company's future earnings, capital requirements, financial requirements and other factors to be determined by the Company's Board of Directors. For the foreseeable future, it is anticipated that earnings, if any, which may be generated from the Company's operations will be used to finance the Company's growth.

Vulnerable Stock Price

If the Company's stockholders sell substantial amounts of their Common Stock (including shares issued upon the exercise of outstanding options), the market price of the Company's Common Stock could fall. As of September 27, 2002 the Company had outstanding 3,996,612 shares of Common Stock, of which 3,177,353 shares are freely tradable in the public market, and of which 819,259 shares are "restricted securities" under the Securities Act of 1933, as amended (the "Securities Act"). The Company's officers, directors and employees own options to purchase up to 1,158,149 additional shares of Common Stock.

Restricted securities may only be sold pursuant to an effective registration statement under the Securities Act or in compliance with Rule 144 under the Securities Act or other exemption from registration. Rule 144 provides that a person holding restricted securities for a period of one year may sell such securities during any three-month period, subject to certain exceptions, in limited amounts. Rule 144 also permits, under certain circumstances, the sale of shares without any quantity limitations by a person who is not our affiliate and who has held the shares for a two year holding period. No predictions can be made as to the effect, if any, that market sales of such shares or the availability of such shares for future sale will have on the market price of the Common Stock prevailing from time to time.

Potential Issuance of Preferred Stock

The Company's Articles of Incorporation authorize 7,500,000 shares of preferred stock, none of which are issued and outstanding as of the date hereof. As provided in the Company's Articles of Incorporation, preferred stock may be issued by resolutions of the Company's Board of Directors from time to time without any action of the stockholders. These resolutions may authorize issuance of the preferred stock and set dividend and liquidation preferences, voting rights, conversion privileges, redemption terms and other privileges and rights. Accordingly, the Company's Board of Directors may, without stockholder approval, issue preferred stock with dividend, liquidation, conversion, voting or other rights which could adversely affect the voting power or the rights of the holders of the Company's Common Stock. The preferred stock could be utilized, under certain circumstances, as a method of discouraging, delaying or preventing a change in control of Pallet Management.

Antitakeover Effects in Our Charter Documents and Under Florida Law

Certain provisions of our Articles and Bylaws may be deemed to have antitakeover effects and may delay, defer or prevent a hostile takeover, including prohibition of shareholder action by written consent and advance notice requirements for shareholder proposals and director nominations In addition, Florida has enacted legislation that may deter or hinder takeovers of Florida corporations. The Florida Control Share Act generally provides that shares acquired in excess of certain specified thresholds will not have any voting rights unless such voting rights are approved by a majority of the corporation's disinterested shareholders. The Florida Affiliated Transactions Act generally requires supermajority approval by disinterested shareholders of certain specified transactions between a public corporation and holders of more than 10% of the outstanding voting shares of the corporation (or their affiliates).

Critical Accounting Policies

Estimates

In preparing financial statements in accordance with accounting principles generally accepted in the United States of America, management makes estimates and assumptions that affect the reported amounts and disclosures of assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company has recorded deferred tax assets of approximately $1,721,000 and $1,297,689 at June 29, 2002 and June 30, 2001, respectively, which are completely offset by valuation allowances. Realization of the deferred tax asset is dependent on generating sufficient taxable income in the future. The amount of the deferred tax asset considered realizable could change in the near term if estimates of future taxable income are modified.

Stock Options (SFAS 123)

Options granted to employees under the Company's Stock Option Plan are accounted for by using the intrinsic method under APB Opinion 25, Accounting for Stock Issued to Employees (APB 25). In October 1995, the Financial Accounting Standards Board issued Statement No. 123, Accounting for Stock-Based

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Compensation (SFAS 123), which defines a fair value based method of accounting for stock options. The accounting standards prescribed by SFAS 123 are optional and the Company has continued to account for stock options under the intrinsic value method specified in APB 25. Pro forma disclosures of net earnings and earnings per share have been made in accordance with SFAS 123.

New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, "Business Combinations" (SFAS 141), which applies to all business combinations initiated after June 30, 2001. This statement requires that all business combinations be accounted for by the purchase method and defines the criteria used to identify intangible assets to be recognized apart from goodwill.

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS 142), which is effective for fiscal years beginning after December 15, 2001, except goodwill and intangible assets acquired after June 30, 2001 are subject immediately to the non-amortization and amortization provisions of this Statement. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the Statement. Other intangible assets will continue to be amortized over their useful lives.

In August 2001, the Financial Accounting Standards Board Issued Statement of Financial Accounting Standards No. 143 "Accounting for Asset Retirement Obligations" (SFAS 143), effective for fiscal years beginning after June 15, 2002. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated retirement costs.

Management believes adoption of these statements will not have a material effect on the financial statements of the Company.

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144 "Accounting for the Impairment or Disposal of Long-lived Assets" (SFAS 144), effective for fiscal years beginning after December 15, 2001 with earlier application encouraged. This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The Company adopted SFAS 144 during the current year, which did not have a material impact on the Company's financial statements. However, the Company did recognize an impairment loss on certain long-lived assets as discussed in Note D.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statement No's. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections" (SFAS 145). This statement, among other things, eliminates an inconsistency between required accounting for certain sale-leaseback transactions and provides for other technical corrections. Management believes adoption of this statement will not have a material effect on the financial statements of the Company.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS 146). This statement addresses accounting and reporting for costs associated with exit or disposal

activities and nullifies Emerging Issues Task Force Issue No. 94-3. The statement is effective for exit or disposal costs initiated after December 31, 2002, with early application encouraged. The Company has not yet adopted this statement, and management has not determined the impact of this statement on the financial statements of the Company.

Refer to "Notes to Consolidated Financial Statements" in "Note A - Summary of Significant Accounting Policies" as part of the Financial Statements attached for other accounting policy discussions.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) Exhibits and Financial Statements and Schedules

(1) Financial Statements:

See Attached.

(2) Financial Statement Schedules:

See Attached.

(3) Exhibits:

See Exhibit Index.

(b) Reports on Form 8-K

None.

Exhibit Index

Exhibit No.	Description
3.1	Articles of Incorporation. (1)
3.2	Amendment to Articles of Incorporation filed June 7, 1985. (1)

3.3	Amendment to Articles of Incorporation filed July 10,1985. (1)
3.4	Amendment to Articles of Incorporation filed October 12, 1994. (1)
3.5	Amendment to Articles of Incorporation filed November 21, 1994. (1)
3.6	Amendment to Articles of Incorporation filed February 3, 1998. (2)
3.7	Amended and Restated By-Laws. (1)
4.1	Specimen Certificate of Common Stock. (1)
10.1	1997 Omnibus Stock Plan. (3)
10.2	1998 Omnibus Stock Plan. (4)
10.3	Employment Agreement between the Company and John C. Lucy, III. (5)
21	Subsidiaries *

(1) Incorporated by reference to the Registrant's Annual Report on Form 10-KSB for the fiscal year ended June 30, 1996.
(2) Incorporated by reference to the Registrant's Registration Statement on Form SB-2 (SEC File Number 333-46245).
(4) Incorporated by referenced to the Annual Report on Form 10-K for the fiscal year ended June 30, 1998.
(5) Incorporated by reference to the Registrant's Proxy Statement filed November 30, 1998.
(6) Incorporated by reference to the Registrant's Quarterly Report on Form 10-QSB for the period ended December 26, 1998.

* Filed herewith.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Amendment No. 1 to the Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

PALLET MANAGEMENT SYSTEMS, INC.

Date: October 21, 2002

By: /s/ Marc S. Steinberg
Marc S. Steinberg, Vice President and Chief Financial Officer

CERTIFICATIONS

I, John C. Lucy, III, certify that:

1. I have reviewed the amendment on Form 10-K/A1 to the Registrant's Form 10-K annual report for the year ended June 29, 2002 (the "Report").

2. Based on my knowledge, the Report, as amended, 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 the Report, as amended.

3. Based on my knowledge, the financial statements, and other financial information included in the Report, as amended, 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 the Report, as amended.

/s/ John C. Lucy, III

Name: John C. Lucy, III
Title: Chief Executive Officer
(Chief Executive Officer)

I, Marc S. Steinberg, certify that:

1. I have reviewed the Report, as amended.

2. Based on my knowledge, the Report, as amended, 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 the Report, as amended.

3. Based on my knowledge, the financial statements, and other financial information included in the Report, as amended, 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 the Report, as amended.

/s/ Marc S. Steinberg

Name: Marc S. Steinberg
Title: Vice President and
Chief Financial Officer
(Chief Financial Officer)

EXPLANATORY NOTE REGARDING CERTIFICATIONS: Representations 4, 5 and 6 of the Certification as set forth in this Form 10-K/A1 have been omitted, consistent with the Transition Provisions of SEC Exchange Act Release No. 34-46427, because this amendment to Annual Report on Form 10-K covers a period ending before the Effective Date of Rules 13a-14 and 15d-14.