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COMMON STOCK, \$0.0001 PAR VALUE

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(Title of class)

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

=====  
Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [ ]

The issuer's revenue for the year ended May 31, 2004, was \$6,964,943.

As of August 18, 2004, the aggregate market value of the voting common stock held by non-affiliates of the registrant, computed by using the average of the high and low price on such date, was \$1,526,717.

As of August 18, 2004, the issuer had outstanding a total of 12,790,451 shares of its \$0.0001 par value common stock.

DOCUMENTS INCORPORATED BY REFERENCE

NONE.

Transitional Small Business Disclosure Format (Check one): Yes [ ] No [X]

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EXPLANATORY NOTE

This Form 10-KSB/A is being filed by Greystone Logistics, Inc. (the "Company"), as Amendment No. 1 to its Annual Report on Form 10-KSB for the fiscal year ended May 31, 2004, to revise Part II, Items 6, 7 and 8A and Part III, Item 13 in the original Form 10-KSB. In general, the amendment:

- o revises the Company's financial statements and management's discussion and analysis to assign a value to a purchase order acquired in connection with the Company's acquisition of the assets of Greystone Plastics, Inc. as an intangible asset apart from goodwill; and
- o modifies the Company's disclosure regarding its controls and procedures.

This Amendment No. 1 to the Company's Annual Report on Form 10-KSB/A amends and restates Part II, Items 6, 7 and 8A and Part III, Item 13 of its original Annual Report on Form 10-KSB. The information included in Items 6 and 7 of Part I has not been updated to reflect events or developments that may have occurred subsequent to May 31, 2004. At the time the Company filed its original Annual Report on Form 10-KSB, the Company's name was PalWeb Corporation and any references below to "PalWeb" shall mean the Company.

PART II

|         |   |
|---------|---|
| ITEM 6. | MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION |
|---------|---|

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### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

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This annual report on Form 10-KSB/A contains "forward-looking" statements regarding potential future events and developments affecting the business of PalWeb. Such statements relate to, among other things: future operations of PalWeb, the development of distribution channels, product sales and potential future financings. Forward-looking statements may be indicated by the words "expects," "estimates," "anticipates," "intends," "predicts," "believes," or other similar expressions. Forward-looking statements appear in a number of places in this Form 10-KSB/A and may address the intent, belief or current expectations of PalWeb and its Board of Directors and management with respect to PalWeb and its business. The forward-looking statements are subject to various risks and uncertainties described in this Form 10-KSB/A. For these reasons, PalWeb's actual results may vary materially from the forward-looking statements.

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### RISK FACTORS

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#### PALWEB CONTINUES TO OPERATE AT A LOSS.

PalWeb was incorporated on February 24, 1969. From April 1993 to December 1997, PalWeb was engaged in various businesses, including the business of exploration, production, and development of oil and gas properties in the continental United States and the operation of related service business. In December 1997, PalWeb acquired all of the issued and outstanding stock of Plastic Pallet Production, Inc., and its principal business changed to selling plastic pallets and plastic injection molding machines. Although PalWeb has completed the construction of a fully operational plastic injection molding machine and commenced the sales of plastic pallets, it continues to incur losses from operations and there is no assurance that it will achieve profitability or obtain funds to finance continued operations.

#### PALWEB'S BUSINESS COULD BE AFFECTED BY CHANGES IN AVAILABILITY OF RAW MATERIALS.

PalWeb uses a proprietary mix of raw materials to produce its plastic pallets. Such raw materials are generally readily available and some may be obtained from recycled plastic containers. At the present time, these materials are being purchased from local suppliers. The availability of PalWeb's raw materials could change at any time for various reasons. For example, the market demand for PalWeb's raw materials could suddenly increase, or the rate at which plastic materials are recycled could decrease, affecting both availability and price. Additionally, the laws and regulations governing the production of plastics and the recycling of plastic containers could change and, as a result, affect the supply of PalWeb's raw materials. Any interruption in the supply of raw materials or components could have a material adverse effect on PalWeb. Furthermore, certain potential alternative suppliers may have pre-existing exclusive relationships with competitors of PalWeb and others that may preclude PalWeb from obtaining its raw materials from such suppliers.

#### PALWEB MAY NOT BE ABLE TO SECURE ADDITIONAL FINANCING NECESSARY TO SUSTAIN AND GROW ITS OPERATIONS.

PalWeb's financial statements have been qualified on a going concern basis principally due to lack of long term financing to achieve its goal of producing and marketing plastic pallets to compete with wood pallets. PalWeb has funded its operations to date primarily through equity and debt financings. PalWeb may need additional debt or capital in order to begin generating a sufficient cash flow to sustain operations for the foreseeable future. PalWeb

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will need to raise substantial additional funds to continue to fund operating expenses or its expansion strategy. There can be no assurance that additional financing will be available, or, if available, that such financing will be on terms favorable to PalWeb. Failure to obtain such additional financing would have a material adverse effect on PalWeb.

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PALWEB'S BUSINESS COULD BE AFFECTED BY COMPETITION AND RAPID TECHNOLOGICAL CHANGE.

PalWeb currently faces competition from many companies that produce wooden pallets at prices that are substantially lower than the prices PalWeb charges for its plastic pallets and other companies that manufacture plastic pallets. It is anticipated that the plastic pallet industry will be subject to intense competition and rapid technological change. PalWeb could potentially face additional competition from recycling and plastics companies, many of which have substantially greater financial and other resources than PalWeb and, therefore, are able to spend more than PalWeb in areas such as product development, manufacturing and marketing. Although a company with greater resources will not necessarily be able to bring a new product to market before its smaller competitors, substantial resources enable a company to support many new products simultaneously, thereby improving the likelihood of at least some of its new products being among the first to make it to market. PalWeb's revenues and profitability could be adversely affected by technological change. Competitors may develop products that render PalWeb's products or proposed products uneconomical or result in products being commercialized that may be superior to PalWeb's products. In addition, alternatives to plastic pallets could be developed, which would have a material adverse effect on PalWeb.

PALWEB IS DEPENDENT ON A FEW LARGE CUSTOMERS.

PalWeb derives, and expects that in the foreseeable future it will continue to derive, substantially all of its revenue from a few large customers. There is no assurance that PalWeb will retain these customers' business at the same level, or at all. The loss of a material amount of business from any one of these customers could have a material adverse effect on PalWeb.

PALWEB MAY NOT BE ABLE TO EFFECTIVELY PROTECT ITS PATENTS AND PROPRIETARY RIGHTS.

PalWeb relies on a combination of patents and trade secrets to protect its proprietary technology, rights and know-how. There can be no assurance that such patent rights will not be infringed upon, that PalWeb's trade secrets will not otherwise become known to or independently developed by competitors, that non-disclosure agreements will not be breached, or that PalWeb would have adequate remedies for any such infringement or breach. Litigation may be necessary to enforce proprietary rights of PalWeb or to defend PalWeb against third-party claims of infringement. Such litigation could result in substantial cost to, and a diversion of effort by, PalWeb and its management and may have a material adverse effect on PalWeb. PalWeb's success and potential competitive advantage is dependent upon its ability to exploit the technology under these patents. There can be no assurance that PalWeb will be able to exploit the technology covered by these patents or that it will be able to do so exclusively. PalWeb currently has certain patent applications pending. There can be no assurance that patent applications will result in patents being issued, or that, if issued, the patents will afford protection against competitors with similar technology.

Although PalWeb is not aware of any claim against it for infringement, there can be no assurances that parties will not bring claims against PalWeb for infringement in the future. PalWeb's ability to commercialize its products and

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proposed products depends, in part, on its ability to avoid

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claims for infringement brought by other parties. Laws regarding the enforceability of intellectual property vary from jurisdiction to jurisdiction. There can be no assurance that intellectual property issues will be uniformly resolved, or that local laws will provide PalWeb with consistent rights and benefits. In addition, there can be no assurance that competitors will not be issued patents that may prevent the manufacturing or marketing of PalWeb's products or proposed products.

PALWEB'S BUSINESS COULD BE AFFECTED BY NEW LEGISLATION REGARDING ENVIRONMENTAL MATTERS.

The business operations of PalWeb are subject to extensive and changing federal, state and local environmental laws and regulations pertaining to the handling and disposition of wastes (including solid and hazardous wastes) or otherwise relating to the protection of the environment. As is the case with manufacturers in general, if a release of hazardous substances occurs on or from PalWeb's properties or any associated off-site disposal location, or if contamination from prior activities is discovered at any of PalWeb's properties, PalWeb may be held liable. No assurances can be given that additional environmental issues will not require future expenditures.

Both the plastics industry, in general, and PalWeb are subject to existing and potential federal, state, local and foreign legislation designed to reduce solid wastes by requiring, among other things, plastics to be degradable in landfills, minimum levels of recycled content, various recycling requirements, disposal fees and limits on the use of plastic products. In addition, various consumer and special interest groups have lobbied from time to time for the implementation of these and other such similar measures. Although PalWeb believes that the legislation promulgated to date and such initiatives to date have not had a material adverse effect on PalWeb, there can be no assurance that any such future legislative or regulatory efforts or future initiatives would not have a material adverse effect on PalWeb.

PALWEB'S BUSINESS WILL BE SUBJECT TO POTENTIAL PRODUCT LIABILITY CLAIMS.

The testing, manufacturing and marketing of PalWeb's products and proposed products involve the inherent risks of product liability claims or similar legal theories against PalWeb, some of which may cause PalWeb to incur significant defense costs. Although PalWeb currently maintains product liability insurance coverage that it believes is adequate, there can be no assurance that the coverage limits of its insurance are adequate or that all such claims will be covered by insurance. In addition, these policies generally must be renewed every year. While PalWeb has been able to obtain product liability insurance in the past, there can be no assurance it will be able to obtain insurance in the future on its products or proposed products. Product liability insurance varies in cost, is difficult to obtain and may not be available in the future on terms acceptable to PalWeb, if at all. A successful product liability claim or other judgment against PalWeb in excess of its insurance coverage could have a material adverse effect upon PalWeb.

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PALWEB CURRENTLY DEPENDS ON CERTAIN KEY PERSONNEL.

PalWeb is dependent on the experience, abilities and continued services of its current management personnel. In particular, Warren Kruger, its President

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and Chief Executive Officer, has played a significant role in the development and management of PalWeb and Bill Hamilton, Vice President of Production, has a significant role in oversight of the manufacturing process. The loss or reduction of services of Warren Kruger, Bill Hamilton, or any other key employee could have a material adverse effect on PalWeb. In addition, there is no assurance that additional managerial assistance will not be required.

PALWEB'S STOCK TRADES IN A LIMITED PUBLIC MARKET, IS SUBJECT TO PRICE VOLATILITY, AND THERE CAN BE NO ASSURANCE THAT AN ACTIVE TRADING MARKET WILL BE SUSTAINED.

There has been a limited public trading market for PalWeb's common stock, and there can be no assurance that an active trading market will be sustained. There can be no assurance that the common stock will trade at or above any particular price in the public market, if at all. The trading price of the common stock could be subject to significant fluctuations in response to variations in quarterly operating results or even mild expressions of interest on a given day. Accordingly, the common stock should be expected to experience substantial price changes in short periods of time. Even if PalWeb is performing according to its plan and there is no legitimate company-specific financial basis for this volatility, it must still be expected that substantial percentage price swings will occur in PalWeb's securities for the foreseeable future.

CERTAIN RESTRICTED SHARES OF PALWEB WILL BE ELIGIBLE FOR SALE IN THE FUTURE AND ARE LIKELY TO BE SOLD IN THE FUTURE, WHICH COULD AFFECT THE PREVAILING MARKET PRICE OF PALWEB'S COMMON STOCK.

Certain of the outstanding shares of common stock are "restricted securities" under Rule 144 of the Securities Act, and (except for shares purchased by "affiliates" of PalWeb as such term is defined in Rule 144) would be eligible for sale as the applicable holding periods expire. In the future, these shares may be sold only pursuant to a registration statement under the Securities Act or an applicable exemption, including pursuant to Rule 144. Under Rule 144, a person who has owned common stock for at least one year may, under certain circumstances, sell within any three-month period a number of shares of common stock that does not exceed the greater of 1% of the then outstanding shares of common stock or the average weekly trading volume during the four calendar weeks prior to such sale. A person who is not deemed to have been an affiliate of PalWeb at any time during the three months preceding a sale, and who has beneficially owned the restricted securities for the last two years is entitled to sell all such shares without regard to the volume limitations, current public information requirements, manner of sale provisions and notice requirements. Sales or the expectation of sales of a substantial number of shares of common stock in the public market by selling stockholders could adversely affect the prevailing market price of the common stock, possibly having a depressive effect on any trading market for the common stock, and may impair PalWeb's ability to raise capital at that time through additional sale of its equity securities.

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PALWEB DOES NOT EXPECT TO DECLARE OR PAY ANY DIVIDENDS IN THE FORESEEABLE FUTURE.

PalWeb has not declared or paid any dividends on its common stock. PalWeb currently intends to retain future earnings to fund the development and growth of its businesses, to repay indebtedness and for general corporate purposes, and, therefore, does not anticipate paying any cash dividends or its common stock in the foreseeable future.

PALWEB'S COMMON STOCK MAY BE SUBJECT TO SECONDARY TRADING RESTRICTIONS RELATED TO PENNY STOCKS.

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Certain transactions involving the purchase or sale of common stock of PalWeb may be affected by a Securities and Exchange Commission rule for "penny stocks" that imposes additional sales practice burdens and requirements upon broker-dealers that purchase or sell such securities. For transactions covered by this penny stock rule, broker-dealers must make certain disclosures to purchasers prior to the purchase or sale. Consequently, the penny stock rule may impede the ability of broker-dealers to purchase or sell PalWeb's securities for their customers and the ability of persons now owning or subsequently acquiring PalWeb's securities to resell such securities.

PALWEB'S PRINCIPAL SHAREHOLDERS OWN A SIGNIFICANT AMOUNT OF COMMON STOCK, GIVING THEM CONTROL OVER CORPORATE TRANSACTIONS AND OTHER MATTERS.

Warren Kruger, President and Chief Executive Officer of PalWeb, and entities with which he is affiliated, beneficially own over 35% of PalWeb's common stock. Paul Kruger, Warren Kruger's brother, and entities with which he is affiliated beneficially owns over 42% of PalWeb's common stock. While these shareholder groups have not agreed to act in concert with respect to all shareholder matters, they may act together in connection with matters presented to the shareholders in the future. This concentrated ownership makes it unlikely that any other holder or group of holders of common stock will be able to affect the way PalWeb is managed or the direction of its business. These factors may also delay or prevent a change in the management or voting control of PalWeb.

### RESULTS OF OPERATIONS

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#### GENERAL

The consolidated statements include PalWeb and its wholly-owned subsidiaries, Greystone Manufacturing, L.L.C., or GSM, and Plastic Pallet Production, Inc., or PPP.

PalWeb's primary business is the manufacturing and selling of plastic pallets through its wholly owned subsidiaries GSM and PPP. GSM is a newly formed subsidiary of PalWeb which acquired substantially all the assets and operations of Greystone Plastics, Inc. GSM manufactures pallets for the beverage industry, operates at full capacity and sells its product to one customer.

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PPP also markets its own designed injection molding machine, the PIPER 600, through a licensing agreement with ForcePro, LLC, which gives ForcePro the exclusive right to market and sell the PIPER 600. Pursuant to the terms of the licensing agreement, PalWeb will receive a royalty of 5% of the gross proceeds from sales of the PIPER 600.

As of May 31, 2004, PalWeb had 60 full-time employees and its production capacity is about 73,000 plastic pallets per month, or 876,000 per year. Production levels have generally been governed by sales and will increase as sales dictate. PalWeb anticipates that a new production line will be installed at its Iowa plant on or before November 15, 2004, at which time PalWeb's production capacity will increase to approximately 84,000 pallets per month, or 1,008,000 per year.

PalWeb has incurred significant losses from operations, and there is no assurance that it will achieve profitability or obtain funds necessary to finance continued operations. See "Liquidity and Capital Resources" under this Item 6.

For all years presented, PalWeb's effective tax rate is 0%. PalWeb has



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

YEAR ENDED MAY 31, 2004 COMPARED TO YEAR ENDED MAY 31, 2003

Sales were \$6,964,943 for fiscal year 2004 compared to \$1,280,945 for fiscal year 2003 for an increase of \$5,683,998. The acquisition of GSM added \$6,029,336 to sales in fiscal year 2004. Sales by PPP declined approximately \$345,000 as a result of relocating the production equipment from its Dallas plant to its Iowa plant as described below.

Cost of sales was \$6,768,426 (97% of sales) and \$2,438,342 (190% of sales) in fiscal years 2004 and 2003, respectively. Production levels were approximately 100% of capacity for GSM in fiscal year 2004 and approximately 10% of capacity for PPP in fiscal years 2004 and 2003. Because of the low production rate for PPP, fixed costs in relation to the level of production resulted in a higher rate of cost of sales to sales. In addition, during fiscal year 2003, substantial costs were incurred during the first quarter in connection with the startup of the PIPER 600 and for the repair and maintenance of the prototype injection molding machine.

General and administrative expense was \$2,041,970 in fiscal year 2004 compared to \$1,312,824 for fiscal year 2003 for an increase of \$729,146. This increase is primarily due to the acquisition of GSM as discussed above, including amortization expense of intangible costs for customer contract in the amount of \$514,002.

Subsequent to the acquisition of GSM, PalWeb elected to consolidate its operations at GSM's plant in Bettendorf, Iowa. The consolidation of PalWeb's manufacturing operations into one facility

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was made by management in order to improve customer service and reduce costs related to manufacturing operations. As a result of the closing of the Dallas plant, PalWeb recorded an expense \$441,949 in fiscal year 2004 which includes \$222,196 for relocation costs and \$219,753 for abandonment of leasehold improvements and estimated costs to settle the outstanding lease agreement on the property. In 2003, PalWeb recorded a one time impairment expense to adjust the cost on its prototype injection molding machine based on estimated future cash flows.

Other income of \$12,134 includes income of \$133,455 primarily from settlement of a claim against a vendor offset by a loss of \$121,321 from the sale of equipment.

Interest expense was \$699,661 in fiscal year 2004 compared to \$433,756 in fiscal year 2003 for an increase of \$265,905.

The consolidated net loss, before the deduction for preferred dividends, in fiscal year 2004 was \$(2,974,929) compared to \$(3,214,852) in fiscal year 2003 for a decrease of \$239,923. This decrease results from the reasons discussed above.

After deducting dividends to preferred stockholders of \$660,171 and \$900,166 in fiscal years 2004 and 2003, respectively, the consolidated net loss available to common stockholders was \$(3,635,100) (\$0.33) per share of common stock) compared to \$(4,115,018) (\$0.79) per share of common stock) in fiscal

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year 2003. The disproportionate decline in the per share amounts from 2003 to 2004 is primarily due to the conversion of the Series 2001 preferred stock into 5,250,000 shares of common stock effective September 8, 2003.

### LIQUIDITY AND CAPITAL RESOURCES

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#### GENERAL

PalWeb's cash requirements for operating activities consist principally of accounts receivable, inventory, accounts payable requirements, operating leases and scheduled payments of interest on outstanding indebtedness. PalWeb is dependent on outside sources of cash to fund its operations. As of May 31, 2004, revenues from sales remain insufficient to meet current liabilities.

A summary of cash flows for the year ended May 31, 2004 is as follows:

|                                       |                |
|---------------------------------------|----------------|
| Cash used in operating activities     | \$ (1,964,405) |
| Cash used in investing activities     | (4,450,436)    |
| Cash provided by financing activities | 6,682,717      |

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Contractual obligations of PalWeb are as follows:

|                  | TOTAL        | LESS THAN<br>1 YEAR | 1-3 YEARS    | 4-5 YEARS    | OV<br>5 YE |
|------------------|--------------|---------------------|--------------|--------------|------------|
|                  | -----        | -----               | -----        | -----        | -----      |
| Long-term debt   | \$ 7,894,111 | \$ 1,503,612        | \$ 2,817,517 | \$ 2,003,575 | \$ 1,56    |
| Operating leases | 6,121,800    | 788,640             | 1,205,160    | 1,152,000    | 2,97       |
| Total            | \$14,015,911 | \$ 2,292,252        | \$ 4,022,677 | \$ 3,155,575 | \$ 4,54    |
|                  | =====        | =====               | =====        | =====        | =====      |

Cash used in investing activities during fiscal 2004 principally consisted of the cash portion of the purchase price of the assets of Greystone Plastics, Inc., which was raised from the sale of the Series 2003 Preferred Stock as described under "Sales of Unregistered Securities" under Item 5 of PalWeb's original Annual Report on Form 10-KSB for the period ended May 31, 2004, which was filed with the SEC on August 30, 2004. PalWeb anticipates equipment additions of approximately \$1,500,000 in fiscal 2005 in connection with the purchase of a new injection molding machine and new molds. PalWeb plans to finance these acquisitions of production equipment either through long-term installment notes or operating leases.

PalWeb anticipates that the cash necessary for funding its operating activities will decline in fiscal 2005 as compared to fiscal 2004 based on its projection of increased sales activities for fiscal 2005. To provide for the additional cash to meet PalWeb's operating activities and contractual obligations for fiscal 2005, PalWeb is exploring various options including long-term debt and equity financing. However, there is no guarantee that PalWeb will be able to raise sufficient capital to meet these obligations.

PalWeb has accumulated a working capital deficit of \$3,748,721 at May 31, 2004, which includes notes payable of \$2,352,667 (\$1,344,501 to entities owned or controlled by Warren Kruger and \$899,980 to a bank), \$1,503,612 for

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current portion of long-term debt and \$1,578,917 in accounts payable and accrued liabilities. This deficit reflects the uncertain financial condition of PalWeb resulting from its inability to obtain long term financing from traditional financing sources. There is no assurance that PalWeb will secure such financing.

As described below, substantially all of the financing that PalWeb has received through May 31, 2004, has been provided by loans from entities controlled Warren Kruger, President and Chief Executive Officer of PalWeb, and from entities affiliated with Paul Kruger, the brother of Warren Kruger, and through the offering of 2001 Preferred Stock and 2003 Preferred Stock described below to the same persons.

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

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### PREFERRED STOCK FINANCING

On January 4, 2002, PalWeb issued 750,000 of Series 2001 convertible preferred stock, \$10.00 par value and convertible at the rate of 7 shares of common for each share of preferred stock, for a total of \$7,500,000. Entities owned by Paul Kruger, acquired 176,302 shares of 2001 Preferred Stock in exchange for the conversion of \$950,200 of existing indebtedness and \$536,745 of equity in the Dallas plant, based on an agreed value of \$1,350,000, less indebtedness assumed by PalWeb of \$813,255. Entities owned or controlled by Warren Kruger acquired 573,698 shares of 2001 Preferred Stock in exchange for \$522,680 in cash and the conversion of \$5,214,297 of existing indebtedness. Effective September 8, 2003, the holders of the Series 2001 preferred elected to convert the outstanding 750,000 shares of preferred stock into 5,250,000 shares of common stock.

Effective September 8, 2003, PalWeb sold 50,000 shares of 2003 Preferred Stock for a total of \$5,000,000 to Paul Kruger as further described under "Sales of Unregistered Securities" under Item 5 of PalWeb's original Annual Report on Form 10-KSB for the period ended May 31, 2004, which was filed with the SEC on August 30, 2004. The proceeds of the offering were primarily used for the acquisition of the assets of Greystone Plastics, Inc.

PalWeb does not anticipate that it will make cash dividend payments to any holders of its common stock unless and until the financial position of PalWeb improves through increased revenues, another financing or otherwise.

### LOANS FROM WARREN KRUGER

Through May 31, 2003, entities owned or controlled by Warren Kruger, had loaned or advanced \$901,422, at an interest rate of 9%, to PalWeb. Effective September 8, 2003, PalWeb authorized the issuance of 629,811 shares of common stock in exchange for the payment of \$900,000 of such indebtedness at an exchange rate of \$1.429 per share of common stock. During fiscal year 2004, an entity owned by Warren Kruger advanced an additional \$1,344,501 for which interest is accrued at an interest rate of 7.5%. At May 31, 2004, advances and accrued interest due to such entities total \$1,344,501 and \$31,713.

### LOAN FROM PAUL KRUGER

Effective January 10, 2003, Paul Kruger refinanced outstanding loans of \$2,150,000 to PalWeb by providing a \$7,000,000 loan at an interest rate of prime plus 3%, due June 4, 2004, secured by all of PalWeb's assets. The additional proceeds were used to pay outstanding bank debt of approximately \$4,242,700 and

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to provide working capital.

Effective September 8, 2003, PalWeb completed a sale and leaseback transaction whereby it sold for agreed upon prices its Dallas, Texas plant for \$1,350,000 and certain production equipment for \$5,650,000 to a company owned by Paul Kruger in exchange for the \$7,000,000 note payable to Paul Kruger. The assets were sold at approximately net book value. The lease agreement for the

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plant is a three year triple net lease with a monthly rental of \$17,720. The equipment lease is for 130 months with a monthly rental of \$48,000 beginning six months after the first day of the lease.

### OTHER

Effective September 8, 2003, PalWeb acquired the assets of Greystone Plastics, Inc., a manufacturer of plastic pallets used in the beverage industry. The purchase price for the assets was \$12,500,000, of which \$4,200,546 was paid in cash and \$8,299,454 was paid by issuing the following notes: a \$5,000,000 note payable by GSM to Greystone Plastics, Inc. at 7.5% interest, due October 1, 2008; a \$2,500,000 note payable by GSM to Greystone Plastics, Inc. at 7.5% interest, due October 1, 2018; and a \$799,454 note payable by GSM to Bill Hamilton, one of the owners of Greystone Plastics, Inc., at 6% interest, due February, 2008. The proceeds from the issuance of the Series 2003 Preferred Stock, described above, were utilized to make the cash payment. As stated above, the terms of the 2003 Preferred Stock and further details relating to the acquisition of the assets of Greystone Plastics, Inc., have been further described in a Form 8-K filed on September 23, 2003 and a related Form 8-K/A filed on February 18, 2004. For more information regarding this transaction, see "Sale and Leaseback of Dallas Plant and Certain Production Equipment" under Item 1 of PalWeb's original Annual Report on Form 10-KSB for the period ended May 31, 2004, which was filed with the SEC on August 30, 2004.

### ITEM 7. FINANCIAL STATEMENTS

The financial statements of PalWeb are set forth on pages F-1 through F-20 inclusive, found at the end of this report.

### ITEM 8A. CONTROLS AND PROCEDURES.

As of May 31, 2004, PalWeb carried out an evaluation under the supervision of PalWeb's Chief Executive Officer and Chief Financial Officer of the effectiveness of the design and operation of PalWeb's disclosure controls and procedures pursuant to the Securities Exchange Act Rules 13a-15(e) and 15d-15(e). Based on this evaluation and at such time, PalWeb's Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures as of May 31, 2004 were effective. However, as previously reported in the Company's amended Quarterly Report on Form 10-QSB for the quarter ended February 28, 2005, the Company recently failed to timely file certain Current Reports on Form 8-K. In addition, the Company has filed a Notification of Late Filing on Form 12b-25 in connection with its Quarterly Report on Form 10-QSB for the quarter ended February 28, 2005, and its Annual Report on Form 10-KSB for the year ended May 31, 2005. As a result of the foregoing, as of the date of this filing, in the opinion of the Company's Chief Executive Officer and Chief Financial Officer, there are material weaknesses in the Company's disclosure controls and procedures and such disclosure controls and procedures were ineffective.

Also as previously reported in its amended Quarterly Report on Form

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10-QSB for the quarter ended February 28, 2005, in an effort to address the deficiencies in the Company's disclosure controls and procedures, the Company has:

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- o caused its outside legal counsel provide the Company's officers and directors with a summary of the new Form 8-K requirements and other reporting requirements and responsibilities applicable to public companies;
- o designated the Company's Chief Financial Officer as the representative of the Company responsible for coordinating with the Company's outside legal counsel in connection with determining if any developments relating to the Company require a filing with the SEC; and
- o implemented new accounting software and hired additional accounting and operational employees in an effort to relieve some of the current burdens of the Company's Chief Financial Officer, which will allow him to focus more time the Company's design and operation of its disclosure controls and procedures.

During the quarter ended May 31, 2004, there was no change in the Company's internal controls over financial reporting that has materially affected, or that is reasonably likely to materially affect, the Company's internal control over financial reporting.

### PART III

#### ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS:

| EXHIBIT NO.<br>----- | DESCRIPTION<br>-----   |
|----------------------|--|
| 2.1                  | Certificate of Ownership and Merger Merging PalWeb Corporation, a Delaware corporation, into PalWeb Oklahoma Corporation, an Oklahoma corporation, filed with the Delaware Secretary of State on May 2, 2002 (incorporated herein by reference to Exhibit 2.1 of PalWeb Corporation's Form 8-K12G3 dated May 2, 2002, which was filed with the SEC on May 24, 2002). |
| 2.2                  | Certificate of Ownership and Merger Merging PalWeb Corporation, a Delaware corporation, into PalWeb Oklahoma Corporation, an Oklahoma corporation, filed with the Oklahoma Secretary of State on May 2, 2002 (incorporated herein by reference to Exhibit 2.2 of PalWeb Corporation's Form 8-K12G3 dated May 2, 2002, which was filed with the SEC on May 24, 2002). |
| 3.1                  | Certificate of Incorporation of PalWeb Oklahoma Corporation filed with the Oklahoma Secretary of State on May 2, 2002 (incorporated herein by reference to Exhibit 3.1 of PalWeb Corporation's Form 8-K12G3 dated May 2, 2002, which was filed with the SEC on May 24, 2002).  |

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| EXHIBIT NO.<br>----- | DESCRIPTION<br>-----  |
|----------------------|---|
| 3.2                  | Bylaws of PalWeb Oklahoma Corporation as adopted on May 2, 2002 (incorporated herein by reference to Exhibit 3.2 of PalWeb Corporation's Form 8-K12G3 dated May 2, 2002, which was filed with the SEC on May 24, 2002).   |
| 4.1                  | Certificate of Incorporation of PalWeb Oklahoma Corporation filed with the Oklahoma Secretary of State on May 2, 2002 (included in Exhibit 3.1).  |
| 4.2                  | Certificate of the Designation, Preferences, Rights and Limitations of PalWeb Corporation's Series 2003 Cumulative Convertible Senior Preferred Stock (incorporated herein by reference to Exhibit 4.1 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003). |
| 10.1                 | License Agreement by and between Westgate Capital Company, L.L.C., and PalWeb Corporation dated April 20, 2001 (incorporated herein by reference to Exhibit 10.21 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2002, which was filed with the SEC on September 13, 2002).                    |
| 10.2                 | Non Exclusive Distribution Agreement between PalWeb Corporation and Bosh Material Handling Incorporated dated August 5, 2002 (incorporated herein by reference to Exhibit 10.23 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2002, which was filed with the SEC on September 13, 2002).      |
| 10.3**               | Form of Indemnity Agreement between Members of the Board of Directors and PalWeb Corporation (incorporated herein by reference to Exhibit 10.30 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2002, which was filed with the SEC on September 13, 2002).                                      |
| 10.4                 | Indemnity Agreement by and between The Union Group, Inc., and Cabec Energy Corp. dated August 31, 1998 (incorporated herein by reference to Exhibit 10.6 of Amendment No. 3 to PalWeb Corporation's Form 10-SB, which was filed on May 2, 2000).  |
| 10.5**               | Stock Option Plan of PalWeb Corporation (effective May 11, 2001), as amended (incorporated herein by reference to Exhibit 10.32 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2002, which was filed with the SEC on September 13, 2002).  |
| 10.6**               | Form of Non-Qualified Stock Option Agreement (incorporated herein by reference to Exhibit 99.8 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2001, which was filed with the SEC on September 13, 2001).   |

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| EXHIBIT NO.<br>----- | DESCRIPTION<br>----- |
|----------------------|----------------------|
|----------------------|----------------------|

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- 10.7\*\* Form of Incentive Stock Option Agreement (incorporated herein by reference to Exhibit 99.9 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2001, which was filed with the SEC on September 13, 2001).
- 10.8\*\* Form of Nonemployee Director Stock Option Agreement (incorporated herein by reference to Exhibit 99.10 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2001, which was filed with the SEC on September 13, 2001).
- 10.9\*\* Form of Employee Director Incentive Stock Option Agreement (incorporated herein by reference to Exhibit 10.36 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2002, which was filed with the SEC on September 13, 2002).
- 10.10 Assignment and Indemnity Agreement between PalWeb Corporation and Paul A. Kruger (regarding transfer of stock of PP Financial, Inc.) dated May 30, 2002 (incorporated herein by reference to Exhibit 10.39 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2002, which was filed with the SEC on September 13, 2002).
- 10.11 Promissory Note in the amount of \$500,000.00 executed by PalWeb Corporation and Plastic Pallet Production, Inc., in favor of Yorktown Management & Financial Services, Inc., dated December 4, 2002 (incorporated herein by reference to Exhibit 10.1 of PalWeb Corporation's Form 10-QSB for the Quarterly Period Ended November 30, 2002, which was filed with the SEC on January 14, 2003).
- 10.12 Letter Agreement between PalWeb Corporation, Plastic Pallet Production, Inc., and Paul A. Kruger dated January 10, 2003 (incorporated herein by reference to Exhibit 10.2 of PalWeb Corporation's Form 10-QSB for the Quarterly Period Ended November 30, 2002, which was filed with the SEC on January 14, 2003).
- 10.13 Loan Agreement between PalWeb Corporation, Plastic Pallet Production, Inc., and Paul A. Kruger dated January 10, 2003 (incorporated herein by reference to Exhibit 10.3 of PalWeb Corporation's Form 10-QSB for the Quarterly Period Ended November 30, 2002, which was filed with the SEC on January 14, 2003).
- 10.14 Promissory Note in the amount of \$7,000,000.00 executed by PalWeb Corporation and Plastic Pallet Production, Inc., in favor of Paul A. Kruger dated January 10, 2003 (incorporated herein by reference to Exhibit 10.4 of PalWeb Corporation's Form 10-QSB for the Quarterly Period Ended November 30, 2002, which was filed with the SEC on January 14, 2003).

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| EXHIBIT NO. | DESCRIPTION  |
|-------------|--|
| -----       | -----  |
| 10.15       | Stock Pledge Agreement executed by PalWeb Corporation in favor of Paul A. Kruger dated January 10, 2003 (incorporated herein by reference to Exhibit 10.5 of PalWeb Corporation's Form 10-QSB for the Quarterly Period Ended November 30, 2002, which was filed with the SEC on January 14, 2003). |

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- 10.16 Security Agreement between PalWeb Corporation, Plastic Pallet Production, Inc., and Paul A. Kruger dated January 10, 2003 (incorporated herein by reference to Exhibit 10.6 of PalWeb Corporation's Form 10-QSB for the Quarterly Period Ended November 30, 2002, which was filed with the SEC on January 14, 2003).
- 10.17 Deed of Trust executed by Plastic Pallet Production, Inc., in favor of Paul A. Kruger dated January 10, 2003 (incorporated herein by reference to Exhibit 10.7 of PalWeb Corporation's Form 10-QSB for the Quarterly Period Ended November 30, 2002, which was filed with the SEC on January 14, 2003).
- 10.18\*\* Letter Agreement between PalWeb Corporation and Lyle W. Miller dated January 10, 2003 (amending terms of outstanding stock options) (incorporated herein by reference to Exhibit 10.8 of PalWeb Corporation's Form 10-QSB for the Quarterly Period Ended November 30, 2002, which was filed with the SEC on January 14, 2003).
- 10.19 Letter Agreement dated January 22, 2003 between Gravity Management & Engineering Group, LLC and PalWeb Corporation (incorporated herein by reference to Exhibit 10.48 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2003, which was filed with the SEC on September 15, 2003).
- 10.20 Asset Purchase Agreement between Greystone Plastics, Inc. and Greystone Manufacturing, L.L.C. dated September 3, 2003 (incorporated herein by reference to Exhibit 10.1 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).
- 10.21 Senior Secured Promissory Note in the amount of \$5,000,000 payable to Greystone Plastics, Inc. (incorporated herein by reference to Exhibit 10.2 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).
- 10.22 Real Estate Note in the amount of \$2,500,000 payable to Greystone Plastics, Inc. (incorporated herein by reference to Exhibit 10.3 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).

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| EXHIBIT NO. | DESCRIPTION  |
|-------------|--|
| -----       | -----  |
| 10.23       | Wraparound Promissory Note in the amount of \$799,454.06 payable to Bill Hamilton (incorporated herein by reference to Exhibit 10.4 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).                               |
| 10.24       | Security Agreement between Greystone Plastics, Inc. and Greystone Manufacturing, L.L.C. dated September 3, 2003 (incorporated herein by reference to Exhibit 10.5 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003). |



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- 10.25\*\*      Employment Agreement between Greystone Manufacturing, L.L.C. and Bill Hamilton dated September 3, 2003 (incorporated herein by reference to Exhibit 10.6 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).
  
- 10.26      Asset Purchase Agreement between Plastic Pallet Production, Inc. and 1607 Commerce Limited Partnership dated September 8, 2003 (incorporated herein by reference to Exhibit 10.7 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).
  
- 10.27      Letter Agreement between Plastic Pallet Production, Inc. and 1607 Commerce Limited Partnership dated September 8, 2003 (incorporated herein by reference to Exhibit 10.8 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).
  
- 10.28      Sale Agreement between Plastic Pallet Production, Inc. and 1607 Commerce Limited Partnership dated September 8, 2003 (incorporated herein by reference to Exhibit 10.9 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).
  
- 10.29      Equipment Lease between 1607 Commerce Limited Partnership and Plastic Pallet Production, Inc. dated September 8, 2003 (incorporated herein by reference to Exhibit 10.10 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).
  
- 10.30      Lease Agreement between 1607 Commerce Limited Partnership and Plastic Pallet Production, Inc. dated September 8, 2003 (incorporated herein by reference to Exhibit 10.11 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).
  
- 10.31      Security Agreement among PalWeb Corporation, Plastic Pallet Production, Inc., Greystone Manufacturing, L.L.C. and 1607 Commerce Limited Partnership dated September 8, 2003 (incorporated herein by reference to Exhibit 10.12 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).

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| EXHIBIT NO.<br>----- | DESCRIPTION<br>-----  |
|----------------------|---|
| 10.32                | Guaranty of Obligations of Tenant Pursuant to Equipment Lease by PalWeb Corporation and Greystone Manufacturing, L.L.C. dated September 8, 2003 (incorporated herein by reference to Exhibit 10.13 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003). |
| 10.33                | Guaranty of Obligations of Tenant Pursuant to Lease by PalWeb Corporation and Greystone Manufacturing, L.L.C. dated September 8, 2003 (incorporated herein by reference to Exhibit 10.14 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003).           |

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- 10.34 Stock Pledge Agreement between PalWeb Corporation and 1607 Commerce Limited Partnership dated September 8, 2003 (incorporated herein by reference to Exhibit 10.15 of PalWeb Corporation's Form 8-K dated September 8, 2003, which was filed with the SEC on September 23, 2003). Employment Agreement between PalWeb Corporation and Warren Kruger dated August 13, 2003.
- 10.35\*\* (incorporated herein by reference to Exhibit 10.35 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2004, which was filed with the SEC on August 30, 2004).
- 11.1 Computation of Loss Per Share is in Note 1 in the Notes to the Financial Statements.
- 21.1 Subsidiaries of PalWeb Corporation (incorporated herein by reference to Exhibit 21.1 of PalWeb Corporation's Form 10-KSB for the Fiscal Year Ended May 31, 2004, which was filed with the SEC on August 30, 2004).
- 23.1 Consent of Murrell, Hall, McIntosh & Co., PLLP (submitted herewith).
- 31.1 Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, and Item 601(b)(31) of Regulation S-B, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (submitted herewith).
- 31.2 Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, and Item 601(b)(31) of Regulation S-B, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (submitted herewith).
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (submitted herewith).

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| EXHIBIT NO. | DESCRIPTION   |
|-------------|---|
| -----       | -----   |
| 32.2        | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (submitted herewith). |

\*\* Management contract or compensatory plan or arrangement required to be filed as an exhibit to this report.

### (b) REPORTS ON FORM 8-K:

On March 24, 2004, PalWeb filed a Form 8-K under Item 12, Results of Operations and Financial Conditions, attaching a press release of PalWeb, which announced PalWeb's results for the third quarter ended February 29, 2004. No financial statements were filed in connection with such Form 8-K.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PALWEB CORPORATION

-----  
(Registrant)

Date: 09/13/05

/s/ Bobby L. Moore

-----  
Bobby L. Moore, President and Chief Executive Officer  
(Principal Executive Officer)

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: 09/13/05

/s/ Bobby L. Moore

-----  
Bobby L. Moore, President, Chief Executive Officer  
and Director  
(Principal Executive Officer)

Date: 09/13/05

/s/ Robert H. Nelson

-----  
Robert H. Nelson, Chief Financial Officer  
(Principal Financial and Accounting Officer)

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Date: 09/13/05 /s/ Marshall S. Cogan  
-----  
Marshall S. Cogan, Director

Date: 09/13/05 /s/ Warren F. Kruger  
-----  
Warren F. Kruger, Director

Date: 09/13/05 /s/ Robert B. Rosene, Jr.  
-----  
Robert B. Rosene, Jr., Director

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INDEX TO FINANCIAL STATEMENTS  
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FINANCIAL STATEMENTS OF PALWEB CORPORATION

Report of Independent Registered Public Accounting Firm.....F-1

Consolidated Balance Sheet.....F-2

Consolidated Statements of Operations .....F-3

Consolidated Statements of Changes in Stockholders' Equity (Deficit).....F-4

Consolidated Statements of Cash Flows .....F-5

Notes to Consolidated Financial Statements.....F-6

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders  
of PalWeb Corporation

We have audited the accompanying consolidated balance sheet (restated) of PalWeb Corporation (an Oklahoma corporation) and its subsidiaries as of May 31, 2004, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows (restated 2004) for each of the years ended May 31, 2004 and 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). The Company is not required to have, nor have we been engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of PalWeb Corporation and its subsidiaries as of May 31, 2004, and the consolidated results of their operations and cash flows for each of the years ended May 31, 2004 and 2003, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has suffered significant losses from operations. Substantial additional funding will be required to implement its business plan and to attain profitable operations. The lack of adequate funding to maintain working capital and stockholders' deficits at May 31, 2004 raises substantial doubt about its ability to continue as a going concern unless additional funds from outside sources, its president or other board members are obtained. Management's plans in regard to these matters are described in Note 2. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

As discussed in Note 18 to the consolidated financial statements, the accompanying consolidated financial statements have been restated.

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Norman, Oklahoma  
August 30, 2005

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PALWEB CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET  
RESTATED (NOTE 18)  
MAY 31, 2004

ASSETS

-----

CURRENT ASSETS:

|                     |            |
|---------------------|------------|
| Cash                | \$ 274,085 |
| Accounts receivable | 951,596    |
| Inventory (Note 3)  | 521,376    |

-----

|                      |           |
|----------------------|-----------|
| TOTAL CURRENT ASSETS | 1,747,057 |
|----------------------|-----------|

|  |           |
|--|-----------|
| PROPERTY, PLANT AND EQUIPMENT, net<br>of accumulated depreciation (Note 4) | 6,589,028 |
|--|-----------|

|                              |           |
|------------------------------|-----------|
| OTHER ASSETS (Note 5 and 14) | 6,140,874 |
|------------------------------|-----------|

-----

|              |               |
|--------------|---------------|
| TOTAL ASSETS | \$ 14,476,959 |
|--------------|---------------|

=====

LIABILITIES AND STOCKHOLDERS' EQUITY

-----

CURRENT LIABILITIES:

|  |              |
|--|--------------|
| Notes payable (Note 6)                     | \$ 2,352,667 |
| Current portion of long-term debt (Note 6) | 1,503,612    |
| Accounts payable and accrued expenses      | 1,578,917    |
| Preferred dividends payable                | 60,582       |

-----

|                           |           |
|---------------------------|-----------|
| TOTAL CURRENT LIABILITIES | 5,495,778 |
|---------------------------|-----------|

|                         |           |
|-------------------------|-----------|
| LONG-TERM DEBT (Note 6) | 6,390,499 |
|-------------------------|-----------|

COMMITMENTS AND CONTINGENCIES (Note 15 and 16)

STOCKHOLDERS' EQUITY (Notes 2, 9 and 10):

|   |              |
|---|--------------|
| Preferred stock, \$0.0001 par value, 20,750,000<br>shares authorized, 50,000 shares outstanding | 5            |
| Common stock, \$0.0001 par value, 5,000,000,000<br>authorized, 12,790,451 shares outstanding    | 1,279        |
| Additional paid-in capital  | 48,265,496   |
| Deficit   | (45,676,098) |

-----

|                            |           |
|----------------------------|-----------|
| TOTAL STOCKHOLDERS' EQUITY | 2,590,682 |
|----------------------------|-----------|

-----

|  |               |
|--|---------------|
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 14,476,959 |
|--|---------------|

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

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PALWEB CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

|   | YEAR ENDED MAY 31,    |                |
|---|-----------------------|----------------|
|   | 2004                  | 2003           |
|   | Restated<br>(Note 18) |                |
| Sales   | \$ 6,964,943          | \$ 1,280,945   |
| Cost of sales, including depreciation of<br>\$357,952 and \$165,736, respectively | 6,768,426             | 2,438,342      |
| Gross profit (loss)   | 196,517               | (1,157,397)    |
| Expenses:   |                       |                |
| General and administrative  | 2,041,970             | 1,312,824      |
| Impairment and relocation expenses  | 441,949               | 310,875        |
| Total expenses  | 2,483,919             | 1,623,699      |
| Operating loss  | (2,287,402)           | (2,781,096)    |
| Other Income (Expense):   |                       |                |
| Other Income  | 12,134                | --             |
| Interest expense  | (699,661)             | (433,756)      |
| Net Loss  | (2,974,929)           | (3,214,852)    |
| Preferred Dividends   | 660,171               | 900,166        |
| Net Loss Available to Common Stockholders   | \$ (3,635,100)        | \$ (4,115,018) |
| LOSS AVAILABLE TO COMMON STOCKHOLDERS PER<br>COMMON SHARE (Note 1)                | \$ (0.33)             | \$ (0.79)      |
| WEIGHTED AVERAGE SHARES OUTSTANDING   | 11,026,000            | 5,201,000      |

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

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PALWEB CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)  
RESTATED (NOTE 18)

|  | PREFERRED STOCK |        | COMMON STOCK |          | PAID-<br>CAPIT |
|--|-----------------|--------|--------------|----------|----------------|
|  | SHARES          | AMOUNT | SHARES       | AMOUNT   |                |
| BALANCES, May 31, 2002                         | 750,000         | 75     | 4,691,625    | 469      | 40,732         |
| Common stock in lieu                           |                 |        |              |          |                |
| 2003 preferred dividends                       | --              | --     | 1,058,263    | 106      | 900            |
| 2002 preferred dividends                       | --              | --     | 132,150      | 13       | 211            |
| Issuance of common stock                       | --              | --     | 40,584       | 4        | 97             |
| Options exercised                              | --              | --     | 16,100       | 2        | 27             |
| Net loss                                       | --              | --     | --           | --       | --             |
| BALANCES, May 31, 2003                         | 750,000         | 75     | 5,938,722    | 594      | 41,969         |
| Common stock in lieu of<br>preferred dividends | --              | --     | 971,918      | 97       | 396            |
| Preferred dividends paid<br>or accrued         | --              | --     | --           | --       | --             |
| Stock issued in exchange<br>for debt           | --              | --     | 629,811      | 63       | 899            |
| Conversion of 2001<br>preferred Stock          | (750,000)       | (75)   | 5,250,000    | 525      |                |
| Issuance of 2003 preferred<br>stock            | 50,000          | 5      | --           | --       | 4,999          |
| Net loss                                       | --              | --     | --           | --       | --             |
| BALANCES, May 31, 2004                         | 50,000          | \$ 5   | 12,790,451   | \$ 1,279 | \$ 48,265      |

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

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PALWEB CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

YEAR ENDED MAY 31,



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|   | 2004<br>-----<br>Restated<br>(Note 18) | 2003<br>-----  |
|---|--|----------------|
| CASH FLOWS FROM OPERATING ACTIVITIES:                                   |  |                |
| Net loss  | \$ (2,974,929)                         | \$ (3,214,852) |
| Adjustments to reconcile net loss to cash used by operating activities: |  |                |
| Depreciation and amortization   | 927,010                                | 230,794        |
| Loss on sale of equipment   | 121,321                                | --             |
| Expenses paid by issuance of common stock                               | --                                     | 57,126         |
| Impairment of investment  | --                                     | 310,875        |
| Changes in accounts receivable  | (603,752)                              | (304,198)      |
| Changes in inventory  | 389,051                                | (180,111)      |
| Changes in other assets   | (26,000)                               | (24,208)       |
| Changes in accounts payable and accrued expenses                        | 668,482                                | 440,265        |
| Change in preferred dividends payable                                   | 60,582                                 | --             |
| Other   | (26,300)                               | --             |
|   | -----                                  | -----          |
| Net cash used in continuing operations                                  | (1,464,535)                            | (2,684,309)    |
| CASH FLOWS FROM INVESTING ACTIVITIES:                                   |  |                |
| Purchase of property and equipment                                      | (701,847)                              | (1,474,475)    |
| Acquisition of assets of Greystone Plastics, Inc.                       | (4,248,459)                            | --             |
|   | -----                                  | -----          |
| Net cash used in investing activities                                   | (4,950,306)                            | (1,474,475)    |
| CASH FLOWS FROM FINANCING ACTIVITIES:                                   |  |                |
| Proceeds from notes and advances payable                                | 2,631,245                              | 8,401,422      |
| Payments on notes payable   | (685,343)                              | (4,277,700)    |
| Preferred dividends paid  | (263,184)                              | --             |
| Proceeds from issuance of common/preferred stock                        | 5,000,000                              | 27,750         |
|   | -----                                  | -----          |
| Net cash provided by financing activities                               | 6,682,717                              | 4,151,472      |
|   | -----                                  | -----          |
| NET INCREASE (DECREASE) IN CASH   | 267,876                                | (7,312)        |
| CASH, beginning of period   | 6,209                                  | 13,521         |
|   | -----                                  | -----          |
| CASH, end of period   | \$ 274,085                             | \$ 6,209       |
|   | =====                                  | =====          |

SUPPLEMENTAL INFORMATION (Note 12)

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

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NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

PalWeb Corporation ("PalWeb") through its wholly-owned subsidiaries Plastic Pallet Production, Inc. ("PPP") and Greystone Manufacturing, LLC ("GSM"), is engaged in the manufacture and marketing of plastic pallets.

Effective June 25, 2002, PalWeb effected a reverse stock split of its par value \$0.0001, common stock whereby each stockholder received one share for each fifty shares held. Fractional shares were rounded up to one share. All previously reported per share common share data has been restated to reflect the reverse split.

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of PalWeb and its subsidiaries. All material intercompany accounts and transactions have been eliminated.

PRIOR YEAR FINANCIAL STATEMENTS

The prior year statement of operations has been restated for comparative purposes.

STATEMENT OF CASH FLOWS

PalWeb considers all short-term investments with an original maturity of three months or less to be cash equivalents.

USE OF ESTIMATES

The preparation of PalWeb's financial statements in conformity with generally accepted accounting principles in the United States of America requires PalWeb's management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. Actual results could differ materially from those estimates.

ACCOUNTS RECEIVABLE AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

PalWeb carries its accounts receivable at their face value less an allowance for doubtful accounts. On a periodic basis, PalWeb evaluates its accounts receivable and establishes an allowance for doubtful accounts based on a combination of specific customer circumstances and credit conditions and based on a history of

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collections. The allowance for doubtful accounts at May 31, 2004 was \$69,727.

INVENTORY

Inventory consists of finished pallets and raw materials and is stated at the lower of cost (first-in, first-out) or market value.

PROPERTY, PLANT AND EQUIPMENT

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-----  
PalWeb's property, plant and equipment is stated at cost. Depreciation expense is computed on the straight-line over the estimated useful lives or the units of production method, as follows:

|   |                                     |
|---|-------------------------------------|
| Plant building .....                          | 39 years                            |
| Production machinery equipment .....          | 5-10 years or Unit<br>of Production |
| Office equipment & furniture & fixtures ..... | 3- 5 years                          |

The production equipment being amortized on the unit of production method had a total cost of \$633,924 at May 31, 2004.

Upon sale, retirement or other disposal, the related costs and accumulated depreciation of items of property, plant or equipment are removed from the related accounts and any gain or loss is recognized. When events or changes in circumstances indicate that assets may be impaired, an evaluation is performed comparing the estimated future undiscounted cash flows associated with the asset to the assets carrying amount. If the asset carrying amount exceeds the cash flows, a write-down to market value or discounted cash flow value is required.

### INVESTMENT

-----  
PalWeb has a 20% ownership in Vimonta AG which is carried on the cost basis of accounting since management has no board representation, financial information or other influence on the operation of Vimonta AG. The asset is valued at \$5,000 and included in other assets.

### GOODWILL

-----  
Goodwill is reviewed annually for impairment relying on a number of factors including operating results, business plans and future cash flows. An impairment charge is recognized for any amount by which the carrying value of goodwill exceed its fair value. Discounted cash flows are used to establish fair values

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### INTANGIBLES

-----  
Customer contract - Customer contract consists of the value assigned to the customer's purchase order from the acquisition of the assets of Greystone Plastics, Inc. (Note 14). This intangible is being amortized on the unit of production of method based on the total estimated unit sales to the customer.

Patents - Amortization expense for the costs incurred by PalWeb to obtain the patents on the modular pallet system and accessories is computed on the straight-line method over the estimated life of 15-17 years.

### STOCK OPTIONS

-----  
PalWeb applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, and related interpretations, in accounting for its stock options. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, established accounting and disclosure requirements for stock-based employee compensation plans. As

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allowed by SFAS No. 123, PalWeb has elected to continue to apply the intrinsic value-based method of accounting under APB No. 25, and has adopted the disclosure requirements of SFAS No. 123 as reflected in Note 10.

### RECOGNITION OF REVENUES

-----

Revenue is recognized when the product is shipped.

### RESEARCH AND DEVELOPMENT COSTS

-----

Research and Development costs are charged to operations in the period incurred.

### INCOME TAXES

-----

PalWeb accounts for income taxes under the liability method, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based in the difference between the financial statements and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

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### LOSS PER SHARE

-----

Basic loss per share is computed by dividing the loss available to common stockholders by the weighted average number of common shares outstanding for the year. In arriving at income (loss) available to common stockholders, preferred stock dividends are added to the net loss for the year. Convertible preferred stock and stock options are not considered as their effect is antidilutive.

### RECENT PRONOUNCEMENTS

-----

In December 2003, the SEC issued Staff Accounting Bulletin ("SAB") No. 104, REVENUE RECOGNITION. This SAB revises or rescinds portions of the revenue recognition interpretive guidance included in the SAB codification to make it consistent with current authoritative accounting guidance. The principal revisions relate to revenue recognition guidance no longer necessary due to developments in U.S. generally accepted accounting principles. The pronouncement had no impact on the Company's historical financial statements.

FASB Interpretation No. 46 (revised December 2003), CONSOLIDATION OF VARIABLE INTEREST ENTITIES, AN INTERPRETATION OF ACCOUNTING RESEARCH BULLETIN NO. 51, addresses consolidation by business enterprises of variable interest entities. PalWeb has no variable interest entities and accordingly this statement has on impact on the company's historical financial statements.

### NOTE 2. CONTINUATION AS A GOING CONCERN

-----

The accompanying financial statements have been prepared assuming that PalWeb will continue as a going concern. PalWeb has suffered significant losses from operations. Currently, management believes that PalWeb has the capacity to produce sufficient plastic pallets to

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achieve profitability; however, sales have not reached such level. To date, PalWeb has received substantial advances from investors but will require additional substantial funding in order to attain its business plan and have an opportunity to achieve profitable operations. Management has been successful in financing its operations primarily through short-term loans and personal guarantees on bank loans by two of its principal stockholders, Paul Kruger and Warren Kruger. Management continues to seek long-term and/or permanent financing. Neither the receipt of additional funding in adequate amounts nor the successful implementation of its business plan can be assured. The combination of these factors raises substantial doubt about PalWeb's ability to continue as a going concern. It is management's opinion that (1) based upon expressions of interest from potential customers, adequate sales will be attained to reach a profitable status, (2) the funding for working capital required to reach necessary production levels will be obtained and (3) PalWeb will continue as a going concern.

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NOTE 3. INVENTORY  
-----

Inventory at May 31, 2004 consists of:

|                       |    |         |
|-----------------------|----|---------|
| Raw materials .....   | \$ | 432,662 |
| Finished goods .....  |    | 88,714  |
|                       |    | -----   |
| Total inventory ..... | \$ | 521,376 |
|                       |    | =====   |

NOTE 4. PROPERTY, PLANT AND EQUIPMENT  
-----

A summary of the property, plant and equipment at May 31, 2004, is as follows:

|  |    |           |
|--|----|-----------|
| Production machinery and equipment ..... | \$ | 4,681,433 |
| Building and land .....                  |    | 2,510,500 |
| Furniture and fixtures .....             |    | 138,246   |
|  |    | -----     |
|  |    | 7,330,179 |
| Less: accumulated depreciation .....     |    | (741,151) |
|  |    | -----     |
|  | \$ | 6,589,028 |
|  |    | =====     |

Depreciation expense for the years ended May 31, 2004 and 2003 is \$377,788 and \$186,388, respectively.

NOTE 5. OTHER ASSETS  
-----

At May 31, 2004, other assets consist of:

|  |    |           |
|--|----|-----------|
| Goodwill .....   | \$ | 3,309,103 |
| Customer's contract, net of accumulated amortization<br>of \$514,002 ..... |    | 2,341,330 |
| Note receivable .....  |    | 314,000   |

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|   |              |
|---|--------------|
| Patents, net of accumulated amortization of \$10,689 .... | 160,841      |
| Investments .....   | 5,000        |
| Deposits and other .....                                  | 10,600       |
|   | -----        |
| Total Other Assets .....                                  | \$ 6,140,874 |
|   | =====        |

Amortization of intangible costs was \$549,222 and \$44,406 in 2004 and 2003, respectively.

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NOTE 6. LONG-TERM DEBT AND NOTES PAYABLE

Long-term debt at May 31, 2004 consists of the following:

|  |              |
|--|--------------|
| Note payable to Greystone Plastics, Inc.,<br>7.5% interest, due September 7, 2008,<br>secured by equipment with net book<br>value of \$3,149,270       | \$ 4,500,000 |
| Note payable to Greystone Plastics, Inc.,<br>7% interest, due September 7, 2018, secured<br>by land and building with net book value of<br>\$2,215,207 | 2,402,747    |
| Note payable to Bill Hamilton, 6% interest,<br>due February, 2008  | 680,474      |
| Note payable to Whaco Plastics, 7.5% interest,<br>due January, 2009  | 264,413      |
| Other notes payable  | 46,477       |
|  | -----        |
| Total  | 7,894,111    |
| Less: Current portion  | 1,503,612    |
|  | -----        |
| Long-term debt   | \$ 6,390,499 |
|  | =====        |

The notes payable to Greystone Plastics, Inc. and Bill Hamilton were debt incurred pursuant to the acquisition of the assets of Greystone Plastics by PalWeb's subsidiary Greystone Manufacturing, LLC. Bill Hamilton commenced employment with PalWeb as of the date of the acquisition in the capacity of Vice President of Production.

Whaco Plastics is an entity owned by Bill Hamilton, Vice President of Production. The issuance of the note for purchase of equipment is described in Note 7, "Related Party Transactions."

Maturities of long term debt for the five years after May 31, 2004 are \$1,503,612, \$1,405,682, \$1,411,835, \$1,376,592, \$626,983, and \$1,569,407 thereafter.

At May 31, 2004, notes payable of \$2,352,667 consist of a note payable to a bank in the amount of \$899,980, prime rate of interest plus 1%, due October 2004, a note payable of \$108,186 to Paul Kruger, 7.5% interest and due October, 2004, and notes payable of \$276,101, due October 2004, and advances of \$1,068,400, all at 7.5% interest, from

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entities owned or controlled by Warren Kruger, President and Chief Executive Officer.

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### NOTE 7. RELATED PARTY TRANSACTIONS

-----  
Bill Hamilton, Vice President of Production, owns a trucking company, Greystone-Bill Hamilton Trucking, that provided freight services totaling \$699,966 for the year ended May 31, 2004. PalWeb believes that the freight rates are equivalent to an arms-length transaction.

GSM paid or accrued fees totaling \$246,870 for grinding services to Whaco Plastics, an entity also owned by Bill Hamilton. A portion of the fees paid to Whaco Plastics is applied to the purchase of a grinder/granulator at a cost of \$280,000, amortized over five years at 7.5% interest.

Until September 8, 2003, PalWeb had a \$7,000,000 note payable to Paul Kruger, a significant stockholder, at an interest rate of prime plus 3%, due June 4, 2004, secured by all of PalWeb's assets. Effective September 8, 2003, PalWeb completed a sale and leaseback transaction whereby it sold for agreed upon prices its plant for \$1,350,000 and certain production equipment for \$5,710,698, including expenses, to 1607 Commerce Limited Partnership, an entity owned by Paul Kruger, in exchange for the \$7,000,000 note payable and accrued interest of \$60,698, which resulted in no gain or loss on the transaction. The lease agreement for the plant is a three year triple net lease with a monthly rental of \$17,720. The equipment lease is for 130 months with a monthly rental of \$48,000 beginning March 8, 2004. The total cost of the lease, \$5,952,000 (\$48,000 per month for 124 months), will be amortized to cost of sales using the unit of production method so the cost is allocated pro rata based on the estimated number of pallets to be produced during the term of the lease. During 2004, the total amounts paid to 1607 Commerce Limited Partnership under these leases totaled \$255,480.

Interest paid or accrued on indebtedness to Paul Kruger was \$133,824 and \$262,886 in 2004 and 2003, respectively, including \$23,376 in 2003 for which Paul Kruger received 15,584 shares of PalWeb common stock in exchange for the debt. The exchange rate of \$1.50 per share was based on the market price of the common stock on the date of authorization.

Interest paid or accrued on notes and advances to entities owned or controlled by Warren Kruger, President and CEO, total \$56,715 and \$23,216 in 2004 and 2003, respectively. Effective May 1, 2004, PalWeb commenced reimbursing an entity owned by Warren Kruger for office rent at \$1,500 per month.

PalWeb has a contract with a consulting engineering firm for the design and supervision of the construction of the new production equipment. The president of the consulting engineers is a Director of PalWeb. Fees paid to the engineering firm were \$4,110 and

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\$124,951 in 2004 and 2003, respectively. In addition, PalWeb paid the director, individually, \$22,500 and \$7,500 in consulting fees during 2004 and 2003, respectively.

A former director of PalWeb provided legal services through a law firm

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of which he is of counsel. The fees for 2004, through the date of his resignation, and 2003 were \$36,009 and \$67,519, respectively.

See Note 15, Commitments and Contingencies, regarding a licensing agreement between PalWeb and Westgate Capital, LLC, an entity owned by directors Warren Kruger and William Pritchard.

Effective June 23, 2003, PalWeb entered into an agreement with ForcePro, LLC, for the right to market and sell PalWeb's injection molding machine, PIPER 600, for a royalty of 5% of the sales price or gross lease payment. Bryan Kirchmer, a director of PalWeb, is a President of ForcePro, LLC.

See also Note 9, "Stockholders' Equity."

### NOTE 8. FEDERAL INCOME TAXES

Deferred taxes as of May 31, 2004 and 2003 are as follows:

|  | 2004         | 2003         |
|--|--------------|--------------|
|  | -----        | -----        |
| Deferred Tax Assets:                                 |              |              |
| Net operating loss                                   | \$ 6,847,091 | \$ 6,839,880 |
| Amortization of intangible costs                     | 82,694       | --           |
| Loss on impairments                                  | 1,057,740    | 1,151,070    |
| Accrued expenses                                     | 151,148      | --           |
| Allowance for doubtful accounts                      | 23,707       | --           |
|  | -----        | -----        |
| Total deferred tax assets                            | 8,162,380    | 7,990,950    |
| Deferred Tax Liabilities:                            |              |              |
| Depreciation and amortization,<br>tax over financial | (244,806)    | (623,359)    |
|  | -----        | -----        |
|  | 7,917,574    | 7,367,591    |
| Less: Valuation allowance                            | (7,917,574)  | (7,367,591)  |
|  | -----        | -----        |
| Total  | \$ --        | \$ --        |
|  | =====        | =====        |

Management has provided a valuation allowance for the full amount of the deferred tax asset as PalWeb continues to incur substantial losses from its operations. While management projects that the products being developed will be profitable and the deferred asset will ultimately be realized, PalWeb has not yet reached sufficient reliability on product acceptance and marketability to reduce the valuation allowance.

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The net change in deferred taxes is as follows:

|                                  | YEAR ENDED MAY 31, |              |
|----------------------------------|--------------------|--------------|
|                                  | 2003               | 2002         |
|                                  | -----              | -----        |
| Net operating losses             | \$ 7,211           | \$ 1,541,712 |
| Depreciation, tax over financial | 394,541            | (475,306)    |
| Amortization of intangible costs | 66,706             |              |
| Accrued expenses                 | 151,148            | --           |



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|                                 |           |             |
|---------------------------------|-----------|-------------|
| Impairments                     | (93,330)  | --          |
| Allowance for doubtful accounts | 23,707    | --          |
| Change in Valuation allowance   | (549,983) | (1,066,406) |
|                                 | -----     | -----       |
| Tax Benefit                     | \$ --     | \$ --       |
|                                 | =====     | =====       |

PalWeb's effective tax rate differs from the federal statutory rate as follows:

|                                       | YEAR ENDED MAY 31, |              |
|---------------------------------------|--------------------|--------------|
|                                       | 2004               | 2003         |
|                                       | -----              | -----        |
| Tax benefit using statutory tax rate  | \$ 1,013,602       | \$ 1,093,050 |
| Effect of state tax rates             | --                 | 96,446       |
| Effect of rate adjustment             | (272,601)          | --           |
| Net change in valuation allowance     | (549,983)          | (1,066,406)  |
| Other                                 | (191,018)          | (123,090)    |
|                                       | -----              | -----        |
| Tax benefit, per financial statements | \$ --              | \$ --        |
|                                       | =====              | =====        |

PalWeb has a net operating loss (NOL) for Federal income tax purposes as of May 31, 2004 of \$20,138,000 as follows:

| AMOUNT       | YEAR OF EXPIRATION |
|--------------|--------------------|
| -----        | -----              |
| \$ 1,290,000 | 2012               |
| 1,291,000    | 2018               |
| 5,871,000    | 2019               |
| 2,634,000    | 2020               |
| 883,000      | 2021               |
| 2,370,000    | 2022               |
| 4,167,000    | 2023               |
| 1,632,000    | 2024               |

NOTE 9. STOCKHOLDERS' EQUITY

Effective June 25, 2002, PalWeb declared a 50 for 1 reverse split of its common stock. References to common shares have been adjusted for the reverse stock split.

In September, 2003, PalWeb issued 50,000 shares of Series 2003, cumulative, convertible preferred stock, par value \$0.0001, to Paul

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Kruger for a total purchase price of \$5,000,000. Each share of the preferred stock has a stated value of \$100.00 and a dividend rate equal to the prime rate of interest plus 3.25% and may be converted into common stock at the conversion rate of \$1.50 per share or an aggregate of 3,333,333 shares of common stock. The holder of the preferred stock has been granted certain voting rights so that such holder has the right to elect a majority of the Board of Directors of PalWeb.

In September, 2003, the holders of the outstanding Series 2001 cumulative, convertible preferred stock, 750,000 shares, converted the

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preferred stock into 5,250,000 shares of common stock for an exchange rate of \$1.429 per share.

In September, 2003, Warren Kruger, President and CEO, exchanged \$900,000 of debt for 629,811 shares of common stock at a rate of \$1.429 per share.

The board of directors authorized issuance of common stock in lieu of cash to pay the dividends on the Series 2001 preferred stock. The rate of exchange is based on the market value of the stock on the date authorized. The issuances are as follows:

| DIVIDEND DATE<br>----- | PREFERRED<br>DIVIDEND<br>----- | COMMON STOCK<br>ISSUED<br>----- | RATE PER SHARE<br>OF COMMON<br>----- |
|------------------------|--------------------------------|---------------------------------|--------------------------------------|
| June 30, 2002          | \$225,000                      | 140,625                         | \$1.60                               |
| September 30, 2002     | \$223,934                      | 149,289                         | \$1.50                               |
| December 31, 2002      | \$226,849                      | 360,078                         | \$0.63                               |
| March 31, 2003         | \$224,384                      | 407,971                         | \$0.55                               |
| June 30, 2003          | \$224,384                      | 560,959                         | \$0.40                               |
| September 8, 2003      | \$172,603                      | 410,959                         | \$0.40                               |

### NOTE 10. STOCK OPTIONS -----

PalWeb has a stock option plan that provides for the granting of options to key employees and non-employee directors. The options are to purchase common stock at not less than fair market value at the date of the grant. The maximum number of shares of common stock for which options may be granted is 20,000,000 of which 18,065,000 are available for grant as of May 31, 2004. Stock options generally expire in ten years from date of grant or upon termination of employment and are generally exercisable one year from date of grant in cumulative annual installments of 25%, except that the options granted in fiscal 2001 were 100% vested at the date of grant.

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Following is a summary of option activity for the three years ended May 31, 2004:

|                                     | SHARES<br>(000'S)<br>----- | WEIGHTED<br>AVERAGE<br>EXERCISE<br>PRICE<br>----- |
|-------------------------------------|----------------------------|---|
| Options outstanding at May 31, 2001 | 190                        | \$ 2.00   |
| Options granted                     | 690                        | 3.18  |
| Options outstanding at May 31, 2002 | 880                        | 2.92  |
| Options granted                     | 760                        | 0.88  |
| Options exercised                   | (25)                       | 2.00  |
| Options cancelled                   | (30)                       | 2.00  |

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|                                     |       |         |
|-------------------------------------|-------|---------|
| Options outstanding at May 31, 2003 | 1,585 | 1.96    |
| Options granted                     | 350   | 0.54    |
|                                     | ----- | -----   |
| Options outstanding at May 31, 2004 | 1,935 | \$ 1.68 |
|                                     | ===== | =====   |
| Exercisable as of May 31, 2002      | 190   | \$ 2.00 |
|                                     | ===== | =====   |
| Exercisable as of May 31, 2003      | 555   | \$ 2.70 |
|                                     | ===== | =====   |
| Exercisable as of May 31, 2004      | 1,131 | \$ 2.16 |
|                                     | ===== | =====   |

With respect to options outstanding at May 31, 2004:

| RANGE          | OPTIONS<br>OUTSTANDING | WEIGHTED<br>AVERAGE<br>LIFE | WEIGHTED<br>AVERAGE<br>PRICE | EXERCISABLE |
|----------------|------------------------|-----------------------------|------------------------------|-------------|
| -----          | -----                  | -----                       | -----                        | -----       |
| \$0.42-\$0.65  | 860,000                | 7.3 years                   | \$0.51                       | 287,500     |
| \$1.429-\$1.60 | 250,000                | 6.5 years                   | \$1.57                       | 138,750     |
| \$2.00         | 135,000                | 4.3 years                   | \$2.00                       | 135,000     |
| \$3.125-\$4.00 | 690,000                | 6.3 years                   | \$3.17                       | 570,000     |
|                | -----                  |                             |                              | -----       |
| Total          | 1,935,000              | 6.6 years                   | \$1.68                       | 1,131,250   |

PalWeb applies APB Opinion No. 25 in accounting for its stock options and, accordingly, no compensation cost has been recognized for its stock options in the financial statements. Had PalWeb determined compensation cost at the grant date based on fair value under SFAS No. 123, PalWeb's net loss would have been increased to the pro forma amount indicated below:

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|                                  | 2004           | 2003           |
|----------------------------------|----------------|----------------|
|                                  | -----          | -----          |
| Net loss to common shareholders: |                |                |
| As reported                      | \$ (3,635,100) | \$ (4,115,018) |
| Pro forma                        | \$ (3,654,691) | \$ (4,230,753) |
| Per share:                       |                |                |
| As reported                      | \$ (0.33)      | \$ (0.79)      |
| Pro Forma                        | \$ (0.33)      | \$ (0.81)      |

The fair value of the options used to compute the compensation cost is estimated using the Black-Scholes option pricing model using the following assumptions:

|                         |      |
|-------------------------|------|
| Dividend Yield          | None |
| Expected Volatility     | 1.36 |
| Risk Free Interest Rate | 4%   |

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Expected Holding Period 4 years

### NOTE 11. FINANCIAL INSTRUMENTS

-----

PalWeb's financial instruments consist principally of accounts payable, accrued liabilities and notes and mortgages payable. Management estimates the market value of the notes and mortgage payable based on expected cash flows and believes these market values approximate carrying values at May 31, 2004 and 2003.

### NOTE 12. SUPPLEMENTAL INFORMATION OF CASH FLOWS

-----

Supplemental information of cash flows for the years ended May 31:

|  | 2004       | 2003      |
|--|------------|-----------|
|  | -----      | -----     |
| Non-cash activities:   |            |           |
| Common stock issuances for:                                      |            |           |
| Retirement of debt   | \$ 900,000 | \$ 97,126 |
| Dividends on preferred stock                                     | 396,987    | 1,111,606 |
| Debt issued in acquisition of assets of Greystone Plastics, Inc. | 8,299,454  | --        |
| Retirement of debt in exchange for property and equipment        | 7,060,698  | --        |
| Note receivable received on sale of equipment                    | 314,000    | --        |
| Interest paid  | 599,792    | 475,835   |

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### NOTE 13. OPERATING LEASES

-----

Rental expense on operating leases totaled \$254,480 and \$212,538 during 2004 and 2003. Commitments for operating leases for the five years after May 31, 2004 are \$788,640, \$629,160, \$576,000, \$576,000, and \$576,000 and \$2,976,000 thereafter.

### NOTE 14. ACQUISITION

-----

Effective September 8, 2003, PalWeb acquired substantially all of the assets of Greystone Plastics, Inc., an Iowa corporation, through the purchase of such assets by a newly formed, wholly-owned subsidiary of PalWeb, Greystone Manufacturing, L.L.C., an Oklahoma limited liability company. The purchase price for the assets was \$12,500,000, of which \$4,200,546 was paid in cash and \$8,299,454 was paid by issuing the following notes: a \$5,000,000 note payable by Greystone Manufacturing, L.L.C. to Greystone Plastics, Inc. at 7.5% interest, due October 1, 2008; a \$2,500,000 note payable by Greystone Manufacturing, L.L.C. to Greystone Plastics, Inc. at 7.5% interest, due October 1, 2018; and a \$799,454 note payable by Greystone Manufacturing, L.L.C. to Bill Hamilton, one of the owners of Greystone Plastics, Inc, at 6% interest, due February, 2008. The cash payment was financed through the issuance of Series 2003 cumulative convertible preferred stock in the amount of

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\$5,000,000 (see Note 9, "Stockholders' Equity"). The acquisition cost of \$12,500,000 plus closing costs of \$47,913 consisted of inventory of \$499,870, building and equipment of \$5,735,695, intangibles (patent and customer contracts) of \$3,003,245 and goodwill of \$3,309,103.

### NOTE 15. CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject PalWeb to concentrations of credit risk consist principally of cash deposits in excess of federally insured limits. As of May 31, 2004, PalWeb's bank balances exceeded federally insured limits by \$174,085.

### NOTE 16. COMMITMENTS AND CONTINGENCIES

In April 2001, PalWeb entered into a Licensing Agreement with Westgate Capital, LLC ("WCC"), an entity owned by Warren Kruger and William Pritchard, providing PalWeb the exclusive right and license to use fire retardancy technology then being developed under the direction and expense of WCC. The Licensing Agreement was negotiated and executed prior to Warren Kruger, William Pritchard or entities which they are affiliated became directors or beneficial owners of 10% or more of PalWeb's common stock in January 2002. Under the agreement, PalWeb must pay the greater of 2.5% of gross sales of UL listed pallets using fire retardant technology or a minimum monthly royalty of \$10,000. The agreement also provided that in the event that cumulative payments to WCC total \$250,000 during the first two years, WCC would convey the ownership of the technology process to

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PalWeb subject to the 2.5% royalty payment. Subsequent to the execution of the original agreement which provided for a "coating" process technology, the fire retardancy process changed to a chemical additive which WCC and PalWeb incorporated in the manufacturing process and used to successfully obtain the UL listing. As of May 31, 2004, no minimum or other royalties have been paid or accrued by PalWeb. However, PalWeb has recorded expenses of approximately \$126,000 that are associated with the license agreement. WCC has not asserted that PalWeb is in default under the license agreement, and WCC has indicated that it has no current intentions of asserting any default by PalWeb under such agreement. PalWeb is exploring the possibility of purchasing the technology from WCC.

PalWeb derives, and expects that in the foreseeable future it will continue to derive, a substantial amount of its revenue from a few large customers of which 2004 sales totaling \$5,940,991 came from one customer. The 2003 sales included amounts of \$301,000 and \$271,227 from individual customers. There is no assurance that PalWeb will retain these customers' business at the same level, or at all. The loss of a material amount of business from any one of these customers could have a material adverse effect on PalWeb.

### NOTE 18. RESTATEMENT OF FINANCIAL STATEMENTS

On August 26, 2005, PalWeb's Board of Directors concluded that the accounting treatment for the acquisition of the assets of Greystone Plastics, Inc., as of September 8, 2003, should have provided for an

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allocation of a portion of the purchase price to place a value on the customer's purchase order in effect at the time of the acquisition. Greystone has calculated this value, \$2,855,332, based on the estimated present value of the future cash flows to be derived from sales to such customer. Further, the accounting treatment for the value of the customer's purchase order should provide for the amortization of such cost over the estimated life based on unit sales. The financial statements for the year ended May 31, 2004 are restated to include amortization expense in the amount of \$514,002 on the value placed on the customer contract; such amortization expense is included under "General and administrative expense," in PalWeb's statement of operations. The net loss available to common stockholders as reported on PalWeb's Form 10-KSB for May 31, 2004 and Form 10-QSB for the first three quarters of fiscal year 2004 is restated to reflect the related amortization expense, as follows:

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| PERIOD                  | AS REPORTED    |           | AS RESTATED    |           |
|-------------------------|----------------|-----------|----------------|-----------|
|                         | AMOUNT         | PER SHARE | AMOUNT         | PER SHARE |
| Year ended May 31, 2004 | \$ (3,121,098) | \$ (0.28) | \$ (3,635,100) | \$ (0.33) |
| February 28, 2004:      |                |           |                |           |
| Nine months then ended  | \$ (1,602,293) | \$ (0.15) | \$ (1,931,923) | \$ (0.18) |
| Three months then ended | (229,635)      | (0.02)    | (409,279)      | (0.03)    |
| November 30, 2003:      |                |           |                |           |
| Six months then ended   | (1,372,239)    | (0.15)    | (1,522,225)    | (0.16)    |
| Three months then ended | (546,969)      | (0.04)    | (696,955)      | (0.06)    |
| August 31, 2003:        |                |           |                |           |
| Three months then ended | (825,670)      | (0.13)    | (825,670)      | (0.13)    |

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