PRECISION AUTO CARE INC
Form 10QSB
November 13, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended September 30, 2007

OR

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

Commission file number 0-29478

PRECISION AUTO CARE, INC.

(Exact name of registrant as specified in its charter)

Virginia	**54-1847851**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

748 Miller Drive, S.E., Leesburg, Virginia 20175

(Address of principal executive offices)

(Zip Code)

703-777-9095

(Registrant s telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year,

if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date 28,993,752 shares of Common Stock as of October 22, 2007.

Transitional Small Business Disclosure Format: Yes o No x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

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FORWARD-LOOKING STATEMENTS

This report includes forward-looking statements within the meaning of the Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934. When used in this report, the words anticipate, believe, estimate, expect, intend and plan as they Care, Inc. or its management are intended to identify such forward-looking statements. All statements regarding Precision Auto Care, Inc. or Precision Auto Care, Inc. s expected future financial position, business strategy, cost savings and operating synergies, projected costs and plans, and objectives of management for future operations are forward-looking statements. Although Precision Auto Care, Inc. believes the expectations reflected in such forward-looking statements are based on reasonable assumptions, no assurance can be given that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from the expectations reflected in the forward-looking statements herein include, among others, the factors set forth in the Company s 10-KSB filing for the year ending June 30, 2007 under the caption Business Risk Factors, general economic and business and market conditions, changes in federal and state laws, and increased competitive pressure in the automotive aftermarket services business.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PRECISION AUTO CARE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

		September 30, 2007 (unaudited)		June 30, 2007
ASSETS				
Current assets:				
Cash and cash equivalents	$	4,977,998	$	4,859,025
Accounts receivable, net of allowance of $199,268 and $215,792, respectively		403,799		371,716
Notes receivable, net of allowance of $163,012 and $155,943, respectively		92,963		110,700
Deferred tax asset		793,098		810,821
Other assets		380,895		414,102
Total current assets		6,648,753		6,566,364
Property and equipment, net		221,680		151,791
Goodwill		9,045,265		8,941,744
Notes receivable, net of allowance of $255,511 and $346,056, respectively		116,838		159,656
Deferred tax asset		4,765,596		4,873,376
Deposits and other		87,519		74,394
Total assets	$	20,885,651	$	20,767,325
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Line-of-credit	$		$	
Notes payable and capital lease obligation- current		26,485		8,989
Accounts payable and accrued liabilities		149,740		257,330
Taxes payable		664,085		551,098
Accrued commission payable		214,007		216,061
Accrued salaries and related expenses		407,356		390,251
Due to related party		142,733		190,801
Deferred revenue		174,755		196,140
Total current liabilities		1,779,161		1,810,670
Notes payable and capital lease obligation, net of current portion		75,476		26,357
Total liabilities		1,854,637		1,837,027
Commitments and contingencies				
Series A redeemable preferred stock, $.01 par value; 1,000,000 shares authorized; 11,227 shares issued and outstanding		116,312		116,312
Stockholders equity:				

Common stock, $.01 par value; 39,000,000 shares authorized; 28,993,752 shares issued and outstanding	289,938	289,938
Additional paid-in capital	67,824,496	67,808,942
Accumulated deficit	(49,199,732)	(49,284,894)
Total stockholders equity	18,914,702	18,813,986
Total liabilities and stockholders equity	$ 20,885,651	$ 20,767,325

See accompanying notes.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended September 30, 2007 (unaudited)	2006 (unaudited)
Revenues:		
Franchise royalties	$ 2,754,142	$ 2,663,983
Franchise development	38,063	50,682
Company-operated retail stores	202,317	
Other	86,713	76,885
Total revenues	3,081,235	2,791,550
Direct cost:		
Franchise support and other	1,804,549	1,798,942
Company-operated retail stores	236,197	
Total direct costs	2,040,746	1,798,942
General and administrative expense	745,724	749,554
Depreciation and amortization expense	17,548	10,185
Operating income	277,217	232,869
Interest expense	(1,176)	(1,446)
Interest income	51,845	53,023
Other income	614	585
Total other income	51,283	52,162
Income before income tax expense	328,500	285,031
Provision for income taxes	136,853	115,700
Net income	191,647	169,331
Preferred stock dividends	582	582
Net income applicable to common shareholders	$ 191,065	$ 168,749
Net income per common share- Basic	$ 0.01	$ 0.01
Net income per common share- Diluted	$ 0.01	$ 0.01
Weighted average common shares outstanding Basic	28,993,752	28,993,752
Weighted average common shares outstanding Diluted	29,044,002	29,241,627

See accompanying notes.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended September 30, 2007 (unaudited)	Three Months Ended September 30, 2006 (unaudited)
Operating activities:		
Net income applicable to common shareholders	$ 191,065	$ 168,749
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,549	10,185
Deferred taxes	125,503	101,827
Stock based compensation (benefit) due to variable accounting	7,675	(18,772)
Stock based compensation	7,879	20,285
Changes in assets and liabilities:		
Accounts and notes receivable	12,951	(29,067)
Prepaid expenses, deposits and other	34,206	(61,437)
Accounts payable and accrued liabilities	(84,873)	44,752
Due to related party	(48,068)	(10,426)
Deferred revenue	(21,385)	3,206
Net cash provided by operating activities	242,502	229,302
Investing activities:		
Purchase of property and equipment	(64,562)	(3,763)
Purchase of company-operated store	(50,000)	
Net cash used in investing activities	(114,562)	(3,763)
Financing activities:		
Payment of preferred stock dividends	(582)	(582)
Payment of capital lease obligation and notes payable	(8,385)	(1,865)
Net cash used in financing activities	(8,967)	(2,447)
Net change in cash and cash equivalents	118,973	223,092
Cash and cash equivalents at beginning of year	4,859,025	4,441,850
Cash and cash equivalents at end of period	$ 4,977,998	$ 4,664,942
Cash paid for the period for:		
Interest	$ 1,176	$ 1,446
Income taxes	$ 10,535	$ 11,885
Supplemental schedule of non cash investing activities:		
Company-operated store acquired under notes payable and release of notes receivable	$ 90,521	$

See accompanying notes.

Precision Auto Care, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Note 1 - Interim Financial Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by US GAAP for complete financial statements. In the opinion of management, all adjustments consisting primarily of recurring accruals considered necessary for a fair presentation have been included. Operating results for such interim periods are not necessarily indicative of the results, which may be expected for a full fiscal year. For further information, refer to the consolidated financial statements and footnotes included in Precision Auto Care Inc. s (the Company) annual report on Form 10-KSB for the year ended June 30, 2007.

Unless the context requires otherwise, all references to the Company herein mean Precision Auto Care, Inc. and those entities owned or controlled by Precision Auto Care, Inc. Significant intercompany accounts and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 2 - Summary of Significant Accounting Policies

Goodwill and Intangible Assets

Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Intangible Assets , requires that goodwill no longer be amortized, but instead be tested for impairment at least annually. The Company engaged a valuation specialist in fiscal year 2007 to assist management with its test for impairment. The fair value of franchising operations was estimated utilizing a discounted cash flow approach that estimates revenue, driven by assumed market growth rates and appropriate discount rates. These estimates are consistent with the plans and estimates management uses to manage the underlying business. The Company carried forward the valuation from fiscal year 2007 for the current year analysis since the fair value of the franchising operations exceeded its carrying value by a substantial margin and the fact that there have been no events and circumstances that have had a material impact on the franchising operations since the most recent fair value determination. Additionally, the Company reviewed the fair value of the company-owned store purchased in fiscal year 2007. Similar to the franchising operations, the fair value of the company-owned store was estimated utilizing a discounted cash flow approach that estimates revenue, driven by assumed market growth rates and appropriate discount rates. Impairment testing is performed in the first quarter of each fiscal year. Based upon the above analysis, management has concluded that the $8.9 million carrying value of goodwill was not impaired. There was additional goodwill of $104,000 associated with the purchase of an operating automotive service center during the first quarter of fiscal year 2008, which was not included in the annual impairment test. However, there were no substantial changes in the operations of the automotive service center that would indicate impairment (see Note 6).

Accounting for Stock Based Compensation

On July 1, 2006 the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees, including grants of employee and director stock options, to be recognized in the income statement based on their fair values. SFAS 123(R) supersedes the Company s previous accounting under Accounting Principles Board Opinion No.25, Accounting for Stock Issued to Employees (APB 25) for the periods beginning fiscal 2007.

The Company adopted SFAS 123(R) using the modified prospective transition method, which required the application of the accounting standard as of July 1, 2006. The Company s Consolidated Financial Statements as of and for three months September 30, 2007 and 2006, respectively, reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company s Consolidated Financial Statements for the prior periods have not been restated to reflect, and do not include the impact of SFAS 123(R). As a result of the adoption of SFAS 123(R), the Company recognized a pre-tax charge of approximately $8,000 and $20,000 (included in general and administrative expenses), $5,000 and $12,000 after-tax and no impact per share on a diluted basis in the quarters ended September 30, 2007 and 2006, respectively, associated with the expensing of stock options. Employee stock option compensation expense includes the estimated fair value of options granted, amortized on a straight-line basis over the requisite service period for the entire portion of the award.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company s Consolidated Statement of Operations. Prior to the adoption of SFAS 123(R), the Company accounted for the stock-based awards to employees and directors using the intrinsic value method. Additionally, certain outstanding stock options are subject to variable accounting. In the three months ended September 30, 2007, the Company recorded compensation expense of approximately $8,000 related to variable accounting for certain outstanding stock options as a result of an increase in the Company s stock price over the related three month period. Conversely, in the three months ended September 30, 2006, the Company recorded a benefit of approximately $19,000 because the Company s stock price declined over the last three months.

A summary of option activity under all plans as of September 30, 2007, and changes during the period then ended is presented below:

	Shares Under Option	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term**
June 30, 2007	1,601,700	0.89	4.54
Options granted			
Options exercised			
Options forfeited			
September 30, 2007	1,601,700	0.89	3.78

No options were granted in the three months ended September 30, 2007 and 2006, respectively. The exercise price of options outstanding at September 30, 2007 ranged from $0.25 to $10.00 per share.

The intrinsic value of in the money options at September 30, 2007 and 2006 was approximately $20,000 and $102,000, respectively.

A summary of the status of the Company s non-vested shares as of September 30, 2007 and changes during the period is presented below:

	Shares Under Option	**Weighted-Average Grant Date Fair Value**
Non-vested shares at June 30, 2007	125,000	.62
Granted		
Vested	125,000	
Forfeited		
Non-vested shares at September 30, 2007		

Note 3 - Earnings Per Share

The Company reports earnings per share (EPS) in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, Earnings per Share which specifies the methods of computation, presentation, and disclosure. SFAS No. 128 requires the presentation of basic EPS and diluted EPS. Basic EPS is calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the period. Diluted EPS is calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the period plus the dilutive effect of common stock equivalents. The number of shares outstanding related to stock options and warrants at September 30, 2007 and 2006 was 1,945,320, respectively. Only stock options and warrants with exercise prices lower than the average market price of the common shares were included in the diluted EPS calculation. For the three months ended September 30, 2007 and 2006, respectively, 1,715,320 and 432,950 shares attributable to outstanding stock options and warrants were not included in the computation of diluted income per share as they were anti-dilutive.

The following table sets forth the computation of basic and diluted net income per share.

	Three Months Ended September 30, 2007		Three Months Ended September 30, 2006	
Numerator:				
Net income	$	191,647	$	169,331
Preferred stock dividends		(582)		(582)
Net income applicable to common shareholders	$	191,065	$	168,749
Denominator:				
Denominator for basic EPS weighted-average-shares		28,993,752		28,993,752
Common stock equivalents- stock options and warrants		50,250		247,875
Denominator for diluted EPS weighted-average-shares		29,044,002		29,241,627
Basic earnings per share applicable to common shareholders	$	0.01	$	0.01
Diluted earnings per share applicable to common shareholders	$	0.01	$	0.01

Note 4 - Contingencies

The Company is subject to litigation that could have a material adverse impact on its liquidity (see Part II Item 1. Legal Proceedings).

Note 5 - Acquisition

On July 24, 2007, the Company purchased an existing Precision Tune Auto Care center in Beltsville, Maryland. This center will be operated as a company-owned store and operations of such have been included in the Company s consolidated financial statements from the purchase date through September 30, 2007. The Company purchased the assets of this center for $141,000. The goodwill of $104,000 is deductible for tax purposes. The following table summarizes the estimated fair values of the assets acquired at the date of acquisition:

Current assets	$	6,000