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PRECISION AUTO CARE INC  
Form 10-Q  
February 12, 2001

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2000

OR

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

For the transition period from July 1, 2000 to December 31, 2000

Commission file number 1-14510

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  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date 8,081,808 shares of Common Stock as of January 31, 2001.

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FORWARD-LOOKING STATEMENTS

This report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934. When used in this report, the words "anticipate," "believe," "estimate," "expect," "intend" and "plan" as they relate to Precision Auto 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

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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-K filing for the year ending June 30, 1999 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 after-market services business.

### PART I - FINANCIAL INFORMATION

#### ITEM 1. FINANCIAL STATEMENTS

##### GENERAL INFORMATION

Precision Auto Care, Inc. ("Precision Auto Care" or the "Company") is a provider of automotive maintenance services with franchised and Company-operated centers located in the United States and in certain international locations. The Company's services are provided to automobile owners and focus on those high frequency items required to properly maintain the vehicle on a periodic basis. The Company offers these services through three "Precision" brands that are intended to be complementary. However, in August 2000, the company made the decision to change senior management and hired a new CEO, Louis M. Brown, Jr. and a new CFO, Robert R. Falconi. With that change in management there has been a change in direction for the Company. Currently the Company's intent is to focus on growing the franchising business.

Precision Tune Auto Care provides automotive maintenance services that require relatively short service times including engine performance, oil change and lubrication and brake services. At December 31, 2000, these services were provided at 581 Precision Tune Auto Care centers owned and operated by franchisees and four owned and operated by the Company.

Precision Auto Wash provides self-service and touch-less automatic car wash services. The advanced operating systems used at prototype Precision Auto Wash centers permit remote monitoring and administration of operations. The no-touch car wash technology employed in Precision Auto Wash centers also provides a high-quality wash with less risk of vehicle damage than traditional car wash systems. At December 31, 2000, there are 30 franchised car wash centers.

Precision Lube Express provides convenient fast oil change and lube services. Because Precision Lube Express centers consist of "above ground" configured modular buildings manufactured and sold by the Company, operations can commence more quickly and with less capital investment than is the case for many competitors. At December 31, 2000, there were 10 Precision Lube Express centers owned and operated by franchisees. As of that date, there were also 17 Lube Depot centers operated by franchisees, some of which are expected to become Precision Lube Express centers.

The Company supports its franchisees and Company-owned centers by distributing certain automotive and car washing parts and supplies, and manufacturing and distributing pre-fabricated modular buildings.

The Company, a Virginia corporation, was incorporated in April 1997, but through predecessors has been in the automotive maintenance services business for over twenty years. The first Precision Tune was established in 1976 to provide quick, convenient and inexpensive engine tune-ups. Franchising of Precision Tune centers began the next year. As changes in automotive technology reduced the need for traditional tune-ups, Precision Tune expanded its menu of offered automotive maintenance services to include oil changes, fuel injection service,

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air conditioning service, cooling system service, brake service and more diagnostic services. In September 1996, the Precision Tune brand name was changed to Precision Tune Auto Care to reflect the shift in emphasis.

The Company is the result of the November 1997 combination of WE JAC Corporation (the owner of Precision Tune Auto Care) and nine other automotive maintenance services companies in connection with the Company's initial public offering (the "IPO Combination"). In March 1998, the Company acquired the holder of the master franchise agreement for Precision Tune Auto Care in Mexico and Puerto Rico.

### PRECISION AUTO CARE, INC. AND SUBSIDIARIES

#### CONSOLIDATED BALANCE SHEETS

#### ASSETS

Current assets:

Cash and cash equivalents.....	\$ 1,
Accounts receivable, net of allowance of \$1,504,394 and \$2,155,735, respectively.....	4,
Inventory, net of allowances of \$600,000.....	1,
Notes receivable, net of allowances of 0 and \$586,000, respectively.....	
Other assets.....	
Deferred income taxes.....	
Total current assets.....	8,
Notes receivable, net of allowance.....	
Property, plant and equipment, at cost.....	7,
Less: Accumulated depreciation.....	(3,
	4,
Goodwill and other intangibles, net of accumulated Amortization of \$14,069,688 and \$14,971,394.....	25,
Deposits and other.....	
Total assets.....	\$ 37, =====

#### LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

Accounts payable and accrued liabilities.....	\$ 10,
Mortgage notes payable.....	
Subordinated debt.....	5,
Other notes payable.....	
Deferred revenue.....	1,
Total current liabilities.....	17,
Notes payable- long term debt.....	10,
Bank facility.....	
Subordinated debt.....	
Mortgage notes payable.....	
Other notes payable.....	

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Deferred revenue.....	4,0
Refundable deposits.....	
Other liabilities.....	
Total liabilities.....	28,
Stockholders' equity:	
Common stock, \$.01 par; 19,000,000 shares authorized; 8,160,508 and 6,434,534 shares issued and outstanding.....	47,
Additional paid-in capital.....	
Unearned restricted stock.....	(38,
Retained earnings (deficit).....	
Total stockholders' equity.....	8,
Total liabilities and stockholder's equity.....	\$ 37, =====

See accompanying notes.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three De -- 2000 (Unaudited)
	-----
Revenues:	
Franchise development	\$ 129,490
Royalties	3,129,656
Manufacturing and distribution	1,790,296
Company centers	389,308
Other	59,581
	-----
Total revenues	5,498,331
Total direct cost	4,833,251
	-----
Contribution (exclusive of amortization shown separately below)	665,080
General and administrative expense	1,399,509
Depreciation expense	263,404
Amortization of franchise rights and goodwill	446,189
Other operating expense	(6,608)
	-----
Operating (loss)	(1,437,414)
Other income (expense):	
Interest expense	(644,431)
Interest income	3,369
	-----

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Total other (expense)	(641,062)
Loss before income tax expense	(2,078,476)
(Benefit) provision for income taxes	28,719
Net loss	\$ (2,107,195)
Basic and diluted net loss per share	\$ (0.26)
Weighted average shares outstanding--Basic and Diluted	8,081,808

See accompanying notes.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Six D 2000 (Unaudited)
Revenues:	
Franchise development	\$ 264,827
Royalties	6,473,601
Manufacturing and distribution	3,691,672
Company centers	1,199,917
Other	97,101
Total revenues	11,727,118
Total direct cost	10,383,661
Contribution (exclusive of amortization shown separately below)	1,343,457
General and administrative expense	2,989,741
Depreciation expense	562,376
Amortization of franchise rights and goodwill	939,566
Other operating expense	49,496
Operating (loss)	(3,197,722)
Other income (expense):	
Interest expense	(1,586,982)
Interest income	13,650
Total other (expense)	(1,573,332)
Loss before income tax expense	(4,771,054)

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(Benefit) provision for income taxes	-
Net loss	\$ (4,771,054)
Basic and diluted net loss per share	\$ (0.61)
Weighted average shares outstanding--Basic and Diluted	7,762,873

See accompanying notes.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

	200
	(Unaudited)
Operating activities:	
Net loss.....	\$ (4,771,054)
Adjustments to reconcile net (loss) to net cash provided by operating activities:	
Depreciation and amortization.....	1,501
Interest expense.....	44
Services received in exchange for stock.....	58
Gain on sale of assets.....	
Changes in operating assets and liabilities:	
Accounts and notes receivable.....	(843)
Inventory.....	55
Prepaid expenses, recoverable income taxes, deposits and other.....	(13)
Accounts payable and accrued liabilities.....	40
Deferred revenue.....	(11)
Net cash (used in) provided by operating activities.....	(3,938)
Investing activities:	
Purchases of property and equipment.....	(53)
Sale of property and equipment.....	8,100
Net cash provided by (used in) investing activities.....	8,046
Financing activities:	
Sale of company stock.....	750
Repayments of bank facility.....	(7,126)
Proceeds from note payable.....	11,250
Repayment of mortgage notes and other notes payable.....	(7,190)
Net cash used in financing activities.....	(2,317)
Net change in cash and cash equivalents.....	1,791
Cash and cash equivalents at beginning of year.....	13

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Cash and cash equivalents at end of period.....

\$ 1,804

=====

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 generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments consisting only 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-K for the year ended June 30, 2000.

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.

The preparation of financial statements in conformity with 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. Significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior period financial information has been reclassified to conform with the current period presentation.

Note 2 - 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 (loss) available to common shareholders by the weighted average number of shares outstanding during the period. Diluted EPS includes the potentially dilutive effect, if any, which would occur if outstanding options and warrants to purchase Common Stock were exercised. For the six months ended December 31, 2000 and 1999, diluted EPS is equivalent to basic EPS as the inclusion of the effect of assumed exercises and conversions of outstanding options and warrants was anti-dilutive.

The following table sets forth the computation of basic and diluted net (loss) per share.

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Numerator:	
Net Loss.....	\$ (4,77
Denominator:	
Denominator for basic EPS-weighted-average shares.....	7,76
Denominator for diluted EPS-weighted-average shares.....	7,76
Basic net loss per share.....	\$
Diluted net loss per share.....	\$

Note 3 - Inventory

The components of inventory are as follows:

	Decemb
	20
	--
Raw materials.....	\$ 75
Work-in-process.....	11
Finished goods.....	1,19
Reserve for obsolete and unsaleable inventory.....	(60
	-----
	\$ 1,46
	=====

Note 4 - Debt

On August 3, 2000, the Board of Directors accepted a proposal from Arthur C. Kellar, a member of the Company's Board of Directors and Desarrollo Integrado, S.A. de C.V., of which a principal is Mauricio Zambrano who is on the Company's Board of Directors, to refinance the Company's existing debt and provide the Company's ongoing working capital needs. The lenders committed to make available a credit facility of \$11.25 million pursuant to certain terms and conditions.

On August 4, 2000, the Company issued subordinated debentures to Arthur C. Kellar and to Desarrollo Integrado, S.A. de C.V. respectively pursuant to which they made a bridge loan to the Company in an aggregate principal amount of \$2.5 million to fund the Company's payroll, payroll taxes, debt service obligations and other immediate needs. The entire principal amount earned interest at a rate of 12% per annum. The entire principal balance was deemed repaid on September 29, 2000.

On September 29, 2000 the Company's remaining debt to First Union was repaid with a facility provided by Precision Funding, LLC a company owned and controlled by Arthur C. Kellar and Desarrollo Integrado, S.A. de C.V.

On October 2, 2000 the Company received \$2.75 million from Precision Funding to use for working capital and to repay the balance of the FFCA mortgages of \$991,000.

In connection with obtaining the above credit facility, an origination fee was paid in the form of a warrant entitling the lenders to purchase 2,000,000 shares of common stock at an exercise price of \$0.275 per share. The issuance of the warrants are subject to shareholder approval. A valuation was performed on the debt and the warrants issued in this transaction. The relative fair market value allocated to the warrants of approximately \$651,000 has been recorded as paid in capital. The discount resulting from recording the value of the warrants is being amortized over the term of the debt agreement.

Note 5 - Contingencies

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The Company is subject to a suit filed in the State of Florida by a former Precision Tune Auto Care franchisee. The franchisee is alleging breach of contract and personal slander. In March 2000, a judgment of approximately \$850,000 plus attorneys' fees was entered against the Company. In connection with this matter, the Company is vigorously appealing the judgment. However, it is not possible to predict whether the appeal will be successful. If the appeal is not successful, payment of the judgment would have a material adverse impact on the liquidity of the Company.

The Company and its subsidiaries are subject to other litigation in the ordinary course of business, including contract, franchisee and employment-related litigation. In the course of enforcing its rights under existing and former franchisee agreements, the Company is subject to complaints and letters threatening litigation concerning the interpretation and applicability of these agreements, particularly in case of defaults and terminations.

### Note 6 - Subsequent Events

None.

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

### Introduction

The following discussion and analysis of the consolidated financial condition and results of operations of Precision Auto Care, Inc. (the "Company") should be read in conjunction with the Consolidated Financial Statements and Notes thereto. Historical results and percentage relationships set forth herein are not necessarily indicative of future operations.

### Results of Operations

Comparison of the three months ended December 31, 2000 to the three months ended December 31, 1999

Summary (in thousands)

	2000	%	1999	%
	----	-	----	-
Net revenue.....	5,498	100%	8,773	100%
Direct cost.....	4,833	88	6,890	79
General and administrative.....	1,400	25	1,479	17
Operating (loss).....	(1,437)	(26)	(616)	(7)

Revenue. Revenue for the three months ending December 31, 2000 was \$5.5 million, a decrease of approximately \$3.3 million, or 38%, compared with revenue of \$8.8 million for the corresponding period of the prior year. The decrease was primarily the result of decreases in retail sales from Company stores of \$800,000, significant reduction in manufacturing and distribution revenues of \$1.8 million, and a reduction of franchise and royalty revenues of \$688,000. The decrease in manufacturing is partially attributable to the disposition of certain manufacturing and distribution businesses. During fiscal year 1999, the Company disposed of an automotive parts and supply distribution business and a chemical manufacturing plant. These businesses accounted for decreases in

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revenue of \$740,000. The Company's Car wash manufacturing revenue was down \$970,000. Royalty revenues were down as a result of fewer franchise centers from the prior year.

**Direct Cost.** Direct costs for the three months ending December 31, 2000 totaled \$4.8 million, a decrease of \$2.1 million or 30%, compared with \$6.9 million for the quarter ending December 31, 1999. The decrease is attributable to cost decreases in company centers and manufacturing and distribution of \$751,000 and \$1.5 million, respectively. These decreases were partially offset by an increase in franchise and royalty expenses of \$168,000.

**General and Administrative Expense.** General and administrative expense was \$1.4 million for the three months ending December 31, 2000, a decrease of \$79,000 or 5%, compared with \$1.5 million for the quarter ending December 31, 1999.

**Operating (Loss).** The Company recorded an operating loss for the three months ending December 31, 2000 was \$1.4 million which represents an increase in operating loss of \$1.4 million or 127% compared with an operating loss of \$616,000 for the corresponding period of the prior year.

Comparison of the six months ended December 31, 2000 to the six months ended December 31, 1999

Summary (in thousands)

	2000	%	1999	%
	----	-	----	-
Net revenue.....	11,727	100%	18,873	100%
Direct cost.....	10,384	89	15,129	80
General and administrative.....	2,990	26	3,298	17
Operating (loss).....	(3,198)	(27)	(1,534)	(8)

**Revenue.** Revenue for the six months ending December 31, 2000 was \$11.7 million, a decrease of approximately \$7.2 million, or 38%, compared with revenue of \$18.9 million for the corresponding period of the prior year. The decrease was primarily the result of decreases in manufacturing and distribution revenues of \$4.5 million, company center operations of \$1.3 million, and a reduction of franchise and royalty revenues of \$1.4 million. The decrease in manufacturing is partially attributable to the disposition of certain manufacturing and distribution businesses. During fiscal year 1999 the Company disposed of an automotive parts and supply distribution business and a chemical manufacturing plant. These businesses accounted for decreases in revenue of \$2.4 million. The

Company's Car wash manufacturing revenue was down \$970,000. Royalty revenues were down as a result of fewer franchise centers from the prior year.

**Direct Cost.** Direct costs for the six months ending December 31, 2000 totaled \$10.4 million, a decrease of \$4.7 million or 31%, compared with \$15.1 million for the six months ending December 31, 1999. The decrease is attributable to cost decreases in company centers and manufacturing and distribution of \$1.3 million and \$4.5 million, respectively. These decreases were partially offset by an increase in franchise and royalty expenses of \$444,000.

**General and Administrative Expense.** General and administrative expense was \$3.0 million for the six months ending December 31, 2000, a decrease of \$308,000 or 9%, compared with \$3.3 million for the six months ending December 31, 1999.

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Operating (Loss). The Company recorded an operating loss for the six months ending December 31, 2000 of \$3.2 million which represents an increase in operating loss of \$1.7 million or 113% compared with an operating loss of \$1.5 million for the corresponding period of the prior year.

TABLE 1 - Components of Depreciation and Amortization Expense

The components of depreciation and amortization expense are summarized as follows:

Three months ended December 31,	2000	1999
Depreciation	\$ 263,404	\$ 361,540
Amortization	446,189	497,793
Total	\$ 709,593	\$ 859,333
Six months ended December 31,	2000	1999
Depreciation	\$ 562,376	\$ 687,264
Amortization	939,566	992,640
Total	\$1,501,942	\$1,679,904

TABLE 2 - Components of Interest Expense

The components of interest expense are summarized as follows:

Three months ended December 31,	2000	1999
Interest incurred	\$ 644,431	\$ 650,666
Six months ended December 31,	2000	1999
Interest incurred	\$1,586,982	\$1,340,603

### Liquidity and Capital Resources

#### Sources and Uses of Cash

The following table sets forth selected information from the statement of cash flows of Precision Auto Care, Inc.

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Net cash (used in) provided by operating activities.....	\$
Net cash provided by (used in) investing activities.....	
Net cash (used in) financing activities.....	
Change in cash and cash equivalents.....	\$

Cash at December 31, 2000 was \$1,804,766 an increase of \$1,791,396 from \$13,370 on June 30, 2000. During the period, cash used by operating activities was \$3.9 million which is attributable to a net loss of \$4.8 million and increases in accounts receivable of \$843,000. These were partially offset by non-cash expenses for depreciation and amortization, services received in exchange for stock and interest expense of \$1.5 million, \$58,000 and \$44,000, respectively. The decrease was further offset by increases of accounts payable and reduction of inventory by \$41,000 and \$55,000, respectively.

Cash provided by investing activities for the quarter ended December 31, 2000 was \$8.0 million. The cash provided by investing activities was the result of sales of car washes and quick lube buildings in Denver, Colorado, Columbus, Ohio and Indianapolis, Indiana for \$4.9 million, \$1.8 million and \$1.4 million, respectively. The sales of the assets was for less than the carrying value of the fixed assets and goodwill combined. This difference was anticipated and accrued as a loss at June 30, 2000. These sales did not impact earnings this fiscal year from these sales. This increase was partially offset by additions of fixed assets of \$53,000.

Cash used in financing activities for the quarter ended December 31, 2000 was \$2.3 million. Cash provided by financing activities during the period included the sale of common stock of \$750,000 and the issuance of a note payable for \$11.3 million. The infusions of cash were offset by repayments of mortgages, the bank facility and other notes payable of \$14.3 million.

### Debt Transactions

As of June 30, 2000, the Company had borrowed approximately \$7.1 million under its bank credit agreement, of which \$3.1 million represented amounts extended under a portion of the bank credit facility that was dedicated to funding acquisitions and capital expenditures (the "Acquisition Line of Credit") and of which \$4.0 million represented funds advanced under a general revolving credit portion of the credit facility (the "Line of Credit Loan").

At June 30, 2000 the Company had a bank credit agreement with First Union National Bank, under which the Bank has extended loans to the Company under both the Line of Credit Loan and Acquisitions Line of Credit. The agreement was originally executed on November 7, 1997 with Signet Bank (which was later acquired by First Union). As of September 29, 2000 both of these credit facilities have been repaid (see discussion below).

Beginning in the summer of 1998, the Company has not always been able to remain in compliance with certain financial covenants included in the agreement. As a result, the agreement has been amended and modified several times including amendments executed October 12, 1998, February 22, 1999 (effective retroactively to February 1, 1999) and May 13, 1999. Prior reports include more detailed descriptions of these earlier amendments and waivers of non-compliance issued by the Bank.

In the latest amendment to the agreement (the "Second Amended and Restated Loan and Security Agreement"), dated October 27, 1999 (effective retroactively to

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October 14, 1999), the Bank extended the maturity date of the credit facilities to October 5, 2000, subject to the satisfaction of certain conditions including the execution of liens on all owned and unencumbered real property. The terms of the extension require the Company to engage in a series of further asset sales generating minimum net proceeds in the aggregate amount of \$2,575,000. In addition, the Company is required to: (a) reduce accounts payable by at least \$250,000 on a cumulative basis, by December 31, 1999, and each quarter thereafter, (b) not suffer, for the quarter ending December 31, 1999, a negative net earnings before taxes, depreciation and amortization, but after interest (excluding accrued or non-cash interest payable on the subordinated debt) exceeding \$500,000, excluding the gain (loss) resulting from the required asset sales, and (c) achieve for each quarter beginning with the quarter ending March 31, 2000, a positive earnings before taxes, depreciation and amortization, but after interest (excluding accrued or non-cash interest payable on the subordinated debt), exclusive of the required asset sales. In addition,

the Company is obligated to reduce bank debt by an additional \$200,000 on or before September 1, 2000, and must continue to make timely payments of principal and interest. The Company is not permitted to make payment of any amount of principal or interest on its subordinated debt in cash without the prior written consent of the Bank. In addition to the above conditions and requirements to dispose of certain businesses which have been satisfied, the Company was required to complete the sale of (1) certain prefabricated lube buildings during the quarters ended December 31, 1999, and March 31, 2000, and (2) the sale of certain real property located in Marion, IN and Roscoe, IL, by certain dates.

The Company was not in compliance with certain financial covenants as of December 31, 1999 and March 31, 2000. As of December 31, 1999, and March 31, 2000, the Company succeeded in reducing accounts payable by the required amount of \$250,000. It also achieved the December 31, 1999, minimum earnings target of no more than \$500,000 loss (as defined above). The requirement of achieving a positive earnings (as defined above) for the quarter ended March 31, 2000 was not achieved. The Company was also not able to complete the remaining real property sales by the specified dates. The Company did receive a waiver from the Bank, dated February 8, 2000, concerning non-compliance with certain covenants for the quarter ended December 31, 1999. The Bank had agreed to provide the Company with a waiver concerning such non-compliance for the quarter ended March 31, 2000 in return for certain modifications to the Second Amended and Restated Loan and Security Agreement. A modification agreement dated May 15, 2000 permanently reduced availability under the Line of Credit \$240,000 by July 10, 2000 and increased the interest rate for all existing and future advances by 1% to 5.75% over LIBOR.

At June 30, 2000 the Company was not in compliance with certain financial covenants. Effective September 29, 2000, the Bank credit facility was repaid (see discussion below).

In addition to the Bank credit facility, the Company has entered into two outstanding subordinated debenture agreements and has received mortgage financing for certain Company-owned real estate. Under the terms of each subordinated debenture, payments of principal and interest on the subordinated debt may only be made by the Company if the Company has made all required payments or is otherwise not in default under the Bank credit facility.

The first subordinated debenture in the amount of \$2 million was executed in October 1998 with an LLC composed of certain members of the Company's board of directors. Originally due October 15, 1999, the maturity of the subordinated debenture has been extended until December 31, 2001. The Company had also agreed that default interest in the amount of \$266,667 would be paid in 71,111 shares of Common Stock. The amount of shares was determined by dividing 266,667 by the average closing price per share of the Corporation's Common Stock in the fifteen

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day period between August 1, 1999 and August 15, 1999. This translates into an issuing price per share of \$3.75. The holder also waived defaults under the agreement through December 31, 2001.

The second subordinated debenture in the amount of \$5 million was executed in January 1999 directly with one member of the Company's board of directors. \$1.4 million of the original principal amount has been repaid. Originally due May 25, 1999, the term of this subordinated debenture had been extended to April 15, 2001 and later extended to December 31, 2001. The holder also waived all debt covenants through December 31, 2001.

On March 8, 1999, the Company entered into a mortgage with Heartland Bank in the principal amount of \$1,035,000 with an annual interest rate of 8.75%, amortized over a 20 year period and secured by four of the Company's car washes. This mortgage was paid off from the sale of the respective secured properties, on December 22, 1999, and January 28, 2000.

On May 17, 1999, the Company executed nineteen promissory notes totaling \$7,204,000, with FFCA Acquisition Corporation. Each note accrued interest at a rate of 9.9% per annum and would have matured on June 1, 2014 with the exception of one which would have matured on August 1, 2004. Principal and interest payments were due in monthly installments that commenced on July 1, 1999. Each note was secured by mortgages on properties. In the event of default the interest rate would have increased to 18%. During the first quarter of fiscal year 2001 the Company repaid all but \$991,000 of this debt with proceeds from sales of car wash and lube centers. On October 2, 2000, the remaining mortgage balance was repaid (see discussion below).

During fiscal year 2001, the Company was successful in obtaining a new source of financing. The Company received \$11.25 million in financing from Precision Funding, L.L.C., a corporation owned by two members of the Company's Board of Directors. With that financing, the Company was able to liquidate its debt with First Union on September 29, 2000 in the amount of \$5.8 million and the remainder of its mortgage debt with FFCA in the amount of \$1.0 million on October 2, 2000. The remaining proceeds of the financing will be used for working capital requirements. The terms of the loan with Precision Funding, L.L.C. do not require the Company to pay any interest for the period of one year or any principal for the period of three years. In light of this financing arrangement, management does not anticipate requiring additional financing to continue the Company's operations for the next year.

From the time that the Company utilized substantially all of its credit facility in August 1998, the Company's cash flow has been constrained. As a result, the Company's ability to meet obligations to its suppliers in a timely manner has been adversely affected,

which in turn has adversely affected revenues and profits of several of its businesses, particularly its distribution business in the U.S. However, with the refinancing, reductions in expenses, improved collections, improved inventory management, the Company expects to be able to meet all of its financial obligations and be able to focus on growing its franchising operation and making it profitable.

While Company management believes that this program will improve cash flow and the ability to meet vendor obligations in a timely manner, there can be no assurance that such program will be effective in meeting its objectives or that if such objectives are met, that the resulting improvements in cash flow will be sufficient to avoid the need for additional reductions in expenditures, sales of additional assets, or supplemental financing.

Seasonality and Quarterly Fluctuations

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Seasonal changes may impact various sectors of the Company's business differently and, accordingly, the Company's operations may be affected by seasonal trends in certain periods. In particular, severe weather in winter months can adversely affect the Company because such weather makes it difficult for consumers in affected parts of the country to travel to Precision Auto Care, Precision Lube Express, and Precision Auto Wash centers. Severe winter weather and rainy conditions may also adversely impact the Company's sale and installation of car wash equipment. Conversely, the Precision Auto Wash business is favorably impacted by normal winter weather conditions as demand for the Company's car wash service increases substantially in winter months.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS

The Company refinanced its debt at a fixed interest rate of 12% and is not subject to changing interest rates.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The Company is subject to a suit filed in the State of Florida by a former Precision Tune Auto Care franchisee. The franchisee is alleging breach of contract and personal slander. In March 2000, a judgment of approximately \$850,000 plus attorneys' fees was entered against the Company. In connection with this matter, the Company is vigorously appealing the judgment. However, it is not possible to predict whether the appeal will be successful. If the appeal is not successful, payment of the judgment would have a material adverse impact on the liquidity of the Company.

The Company and its subsidiaries are subject to other litigation in the ordinary course of business, including contract, franchisee and employment-related litigation. In the course of enforcing its rights under existing and former franchisee agreements, the Company is subject to complaints and letters threatening litigation concerning the interpretation and applicability of these agreements, particularly in case of defaults and terminations.

The Company has reserves in its accounts for litigation based on management's best judgment. Except as discussed above with respect to the Florida matter, management is of the opinion that the ultimate liability in respect of litigation is not likely to be of material importance to the Company's financial condition and results of operations.

### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

On August 4, 2000 the Company issued 1,700,000 shares of common stock to Louis Brown for \$750,000. The proceeds were used to fund the Company's working capital.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

The information concerning defaults and the subsequent cure thereof with respect to the Company's indebtedness contained in Note 3 to the Company's financial statements and appearing at "Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources" is incorporated herein by reference.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

### ITEM 5. OTHER INFORMATION



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None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit No.	Description
27	Financial Data Schedule

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on November 15, 2000.

Precision Auto Care, Inc.

By: /s/ Louis M. Brown  
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Louis M. Brown  
President and Chief Executive Officer  
(Duly Authorized Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature -----	Title -----	Date ----
/s/ Louis M. Brown -----	President, Chief Executive Officer and Director (Principal Executive Officer)	February __, 2000
Louis M. Brown		
/s/ Robert R. Falconi -----	Senior Vice President and Chief Financial Officer (Principal Financial Accounting Officer)	February __, 2000
Robert R. Falconi		

EXHIBIT INDEX

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