PRECISION AUTO CARE INC
Form 10QSB
February 08, 2008

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 December 31, 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
(Address of principal executive offices)

20175
(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 January 31, 2008.

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

	December 31, 2007 (unaudited)	June 30, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,222,722	$ 4,859,025
Accounts receivable, net of allowance of $188,158 and $215,792, respectively	621,760	371,716
Notes receivable, net of allowance of $171,056 and $155,943, respectively	82,714	110,700
Deferred tax asset	800,699	810,821
Other assets	376,269	414,102
Total current assets	6,104,164	6,566,364
Property and equipment, net	792,501	151,791
Goodwill	9,256,265	8,941,744
Notes receivable, net of allowance of $247,468 and $346,056, respectively	112,322	159,656
Deferred tax asset	4,704,726	4,873,376
Deposits and other	114,634	74,394
Total assets	$ 21,084,612	$ 20,767,325
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Line-of-credit	$	$
Notes payable and capital lease obligation- current	111,804	8,989
Accounts payable and accrued liabilities	162,867	257,330
Taxes payable	663,127	551,098
Accrued commission payable	233,361	216,061
Accrued salaries and related expenses	390,111	390,251
Due to related party	135,705	190,801
Deferred revenue	149,625	196,140
Total current liabilities	1,846,600	1,810,670
Notes payable and capital lease obligation, net of current portion	93,261	26,357
Total liabilities	1,939,861	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	67,862,871	67,808,942
Accumulated deficit	(49,124,370)	(49,284,894)
Total stockholders equity	19,028,439	18,813,986
Total liabilities and stockholders equity	$ 21,084,612	$ 20,767,325

See accompanying notes

PRECISION AUTO CARE, INC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended December 31,			
		2007 (unaudited)		**2006 (unaudited)**
Revenues:				
Franchise royalties	$	2,614,478	$	2,523,264
Franchise development		60,899		92,938
Company-operated retail stores		263,438		129,421
Other		92,539		77,857
Total revenues		3,031,354		2,823,480
Direct costs:				
Franchise support		1,802,219		1,990,781
Company-operated retail stores		290,760		143,144
Total direct costs		2,092,979		2,133,925
General and administrative expense		837,239		769,504
Depreciation and amortization expense		20,759		15,621
Operating income (loss)		80,377		(95,570)
Interest expense		(1,103)		(3,681)
Interest income		55,094		50,787
Other income		90		
Total other income		54,081		47,106
Income (loss) before income tax expense		134,458		(48,464)
Provision (benefit) for income taxes		58,514		(11,371)
Net income (loss)		75,944		(37,093)
Preferred stock dividends		582		582
Net income (loss) applicable to common shareholders	$	75,362	$	(37,675)
Net income per common share- Basic	$	0.00	$	0.00
Net income per common share- Diluted	$	0.00	$	0.00
Weighted average common shares outstanding- Basic		28,993,752		28,993,752
Weighted average common shares outstanding- Diluted		29,284,627		29,089,694

See accompanying notes

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PRECISION AUTO CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Six Months Ended December 31, 2007 (unaudited)	Six Months Ended December 31, 2006 (unaudited)
Revenues:		
Franchise royalties	$ 5,368,619	$ 5,187,246
Franchise development	98,962	143,619
Company-operated retail stores	465,755	129,421
Other	179,253	154,742
Total revenues	6,112,589	5,615,028
Direct costs:		
Franchise support	3,606,768	3,789,723
Company-operated retail stores	526,957	143,144
Total direct costs	4,133,725	3,932,867
General and administrative expense	1,582,964	1,519,058
Depreciation and amortization expense	38,308	25,806
Operating income	357,592	137,297
Interest expense	(2,279)	(5,127)
Interest income	106,939	103,811
Other income	705	585
Total other income	105,365	99,269
Income before income tax expense	462,957	236,566
Provision for income taxes	195,367	104,329
Net income	267,590	132,237
Preferred stock dividends	1,163	1,163
Net income applicable to common shareholders	$ 266,427	$ 131,074
Net income per common share- Basic	$ 0.01	$ 0.00
Net income per common share- Diluted	$ 0.01	$ 0.00
Weighted average common shares outstanding- Basic	28,993,752	28,993,752
Weighted average common shares outstanding- Diluted	29,144,648	29,170,408

See accompanying notes.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended December 31, 2007 (unaudited)		Six Months Ended December 31, 2006 (unaudited)	
Operating activities:				
Net income applicable to common shareholders	$	266,427	$	131,074
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		38,310		25,806
Bad debt expense				20,000
Deferred taxes		178,772		82,385
Stock based compensation (benefit) due to variable accounting		46,050		(45,633)
Stock based compensation		7,879		28,435
Changes in assets and liabilities:				
Accounts and notes receivable		(190,245)		(15,258)
Prepaid expenses, deposits and other		42,216		(24,450)
Accounts payable and accrued liabilities		(70,014)		(49,828)
Due to related party		(55,096)		(10,247)
Deferred revenue		(46,515)		(30,400)
Net cash provided by operating activities		217,784		111,884
Investing activities:				
Purchase of property and equipment		(82,643)		(13,784)
Purchase of company-operated stores		(750,000)		(330,000)
Net cash used in investing activities		(832,643)		(343,784)
Financing activities:				
Payment of preferred stock dividends.		(1,163)		(1,163)
Payment of capital lease obligation and notes payable		(20,281)		(3,794)
Net cash used in financing activities		(21,444)		(4,957)
Net change in cash and cash equivalents		(636,303)		(236,857)
Cash and cash equivalents at beginning of year		4,859,025		4,441,850
Cash and cash equivalents at end of period	$	4,222,722	$	4,204,993
Cash paid for the period for:				
Interest	$	2,279	$	5,127
Income taxes	$	18,135	$	54,173
Supplemental schedule of non cash investing activities:				
Company-operated stores acquired under notes payable and release of notes receivable	$	205,521	$	

See accompanying notes.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES

NOTES TO THE 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 $315,000 associated with the purchase of two operating automotive service centers during the first and second quarters 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 centers that would indicate impairment.

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 six months ended December 31, 2007 and 2006, respectively, reflect 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 $28,000 (included in general and administrative expenses), $5,000 and $16,000 after-tax and no impact per share on a diluted basis in the periods ended December 31, 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 six months ended December 31, 2007, the Company recorded compensation expense of approximately $46,000 related to variable accounting for certain outstanding stock options as a result of an increase in the Company s stock price over the related six month period. Conversely, in the six months ended December 31, 2006, the Company recorded a benefit of approximately $46,000 because the Company s stock price during this period.

A summary of option activity under all plans as of December 31, 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			
December 31, 2007	1,601,700	0.89	3.53

No options were granted in the six months ended December 31, 2007 and 2006, respectively. The exercise price of options outstanding at December 31, 2007 ranged from $0.25 to $10.00 per share.

The intrinsic value of in the money options at December 31, 2007 and 2006 was approximately $36,000 and $71,000, respectively.

A summary of the status of the Company s non-vested shares as of December 31, 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 December 31, 2007		

Reclassifications

Certain amounts on the prior period financial statements have been reclassed to be in conformity with the current period financial statements.

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 December 31, 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 and six months ended December 31, 2007 and 2006, respectively, 557,950 and 432,950 shares attributable to outstanding stock options 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		Six Months Ended	
	December 31, 2007	December 31, 2006	December 31, 2007	December 31, 2006
Numerator:				
Net income (loss)	$ 75,944	$ (37,093)	$ 267,590	$ 132,237
Preferred stock dividends	(582)	(582)	(1,163)	(1,163)
Net income (loss) applicable to common Shareholders	$ 75,362	$ (37,675)	$ 266,427	$ 131,074
Denominator:				
Denominator for basic EPS weighted- average-shares	28,993,752	28,993,752	28,993,752	28,993,752
Common stock equivalents- stock options and warrants	290,875	95,942	150,896	176,656
Denominator for diluted EPS weighted- average-shares	29,284,627	29,089,694	29,144,648	29,170,408
Basic earnings per share applicable to common shareholders	$ 0.00	$ 0.00	$ 0.01	$ 0.00
Diluted earnings per share applicable to common shareholders	$ 0.00	$ 0.00	$ 0.01	$ 0.00

Note 4 Acquisitions

On December 5, 2007, the Company purchased a center in Northern Virginia. 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 December 31, 2007. The Company purchased the land and assets for $640,000 with up to an additional $90,000 available to the seller if certain sales objectives are met. Per the purchase agreement, an additional $5,000 will be paid each month during the first eighteen months after the execution of agreement if the center reaches net sales of $48,000 per month. The goodwill is deductible for tax purposes. The following table summarizes the estimated fair values of the land and assets acquired at the date of acquisition:

Current assets	$ 5,000
Equipment	44,000
Intangible asset	30,000
Land	121,900
Building	228,100
Goodwill	211,000 - 301,000
Total assets acquired	$ 640,000 - 730,000

On December 13, 2007, the Company purchased the land and building of a site previously operated as a Precision Tune Auto Care center in Detroit, Michigan. The operations of the center began in January 2008, and will be included in the Company s consolidated financial statements for the period ended March 31, 2008. The Company purchased the land and building for $175,000. The following table summarizes the estimated fair values of the land and building acquired at the date of acquisition:

Land	$ 69,000
Building	106,000

Total assets acquired	$	175,000

Note 5 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 6 Recently Issued Accounting Standards

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007), Business Combinations, which replaces SFAS No 141. The statement retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in the purchase accounting. It also changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process res