PRECISION AUTO CARE INC
Form 10-Q
February 14, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2001

OR

[ ] 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 (I.R.S. Employer
incorporation or organization) 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date 10,724,308 shares of Common Stock as of January 25, 2002.

Precision Auto Care, Inc.

Form 10-Q

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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 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 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 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

General Information

Precision Auto Care, Inc. ("PACI" or the "Company") is a provider of automotive maintenance services with both franchised and company-operated centers located in the United States and in certain foreign countries. At December 31, 2001, the Company had 59 employees. Its services are provided to automobile owners and focus on those high frequency items required on a periodic basis to maintain the vehicle properly. The Company offers these services through three brands that are intended to be complementary:

- Precision Tune Auto Care ("PTAC") provides automotive maintenance services, such as engine performance, oil change and lubrication and brake services, that require relatively short service times. At December 31, 2001, these services were provided at 601 Precision Tune Auto Care centers owned and operated by franchisees.

- 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, the Company believes that operations commence more quickly and with less capital investment than is the case for many competitors. At December 31, 2001, there were 16 Precision Lube Express centers owned and operated by franchisees. In the future, the Company intends to grow this part of the business primarily through its co-branding relationship with Petro USA, Inc., a subsidiary of Getty Petroleum Marketing, Inc., and potential co-branding relationships with other petroleum retailers.

- Through HydroSpray Car Wash Equipment, Co., Inc, one of its subsidiaries, the Company manufactures, distributes and sells car wash equipment. It also manufactures and installs the modular building and equipment system used by Precision Lube Express centers, although there have not been any purchases of Hydrospray products by Precision Lube Express centers for the past 18 months. It also sells these modular buildings to third parties for various commercial applications. The Company believes that the HydroSpray equipment package is a leading car wash equipment package on the market. It includes such unique features as an integrated computer system that controls the auto wash system and allows remote dial-in access for system status reports and the diagnosis of maintenance problems along with its recently redesigned automatic tower and track that adjusts to

the size of each vehicle.

The Company also operates a manufacturing facility that produces dryers for car washes. That business is currently being marketed by the Company for sale as it does not fit into its future plans. The Company believes that greater revenues and margins can be realized by investing the proceeds from this sale into its core business.

The Company was incorporated as a Virginia corporation in April 1997, but its predecessors have 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 automotive technology changed, Precision Tune expanded its menu of offered automotive maintenance services to include oil changes, fuel injection service, 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 its initial public offering. In March 1998, the Company acquired the holder of the master franchise agreement for Precision Tune Auto Care in Mexico and Puerto Rico. The master franchise agreement for Mexico was sold in January 2002.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 3
	2001
	(Unaudite
ASSETS	
Current assets:	
Cash and cash equivalents	$315,8
Accounts receivable, net of allowance of $564,752 and $331,793 Respectively	1,500,0
Inventory, net of allowance of $0 and $213,770, respectively	2,272,8
Other assets	155,7
Assets held for sale	1,549,1
Total current assets	5,793,7
Property, plant and equipment, at cost	4,655,0
Less: Accumulated depreciation	(3,344,4

	1,310,6
Goodwill and other intangibles, net of accumulated amortization of $15,896,579 and $15,665,423, respectively	10,446,6
Deposits and other	28,0
Total assets	$17,579,1

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

Current liabilities:	
Accounts payable and accrued liabilities	$6,800,8
Related party payable- Board LLC	1,260,6
Other notes payable- current	758,6
Deferred revenue	746,1
Total current liabilities	9,566,2
Credit facility with related party	10,836,8
Subordinated debt	3,586,9
Other notes payable- non current	120,6
Accrued interest on related party debt	3,067,5
Deferred revenue and other	2,5
Total liabilities	27,180,7
Commitments and contingencies:	
Stockholders' equity (deficit):	
Common stock, $.01 par; 19,000,000 shares authorized; 10,724,308 and 9,149,308 shares issued and outstanding	107,2
Additional paid-in capital	48,574,8
Unearned restricted stock	(16,0
Accumulated deficit	(58,267,7
Total stockholders' deficit	(9,601,6
Total liabilities and stockholders' equity	$17,579,1

See accompanying notes.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Mont Decembe
	2001 (Unaudited)

Revenues:		
Franchise development	$112,247	$
Royalties	2,587,437	3,
Manufacturing and distribution	1,779,015	1,
Company centers	404,606	
Other	73,728	
Total revenues	4,957,033	5,
Direct costs:		
Royalties	2,393,191	3,
Manufacturing and distribution	1,531,607	1,
Total direct cost	3,924,798	4,
Contribution (exclusive of amortization shown separately below)	1,032,235	1,
General and administrative expense	1,930,418	1,
Depreciation expense	217,222	
Amortization of franchise rights and goodwill	311,508	
Charge for impairment of capitalized software	202,909	
Charge for impairment of goodwill	1,100,523	
Operating loss	(2,730,345)	(1,
Other income (expense):		
Interest expense	(532,784)	(
Interest income	1,766	
Other	(481)	
Total other (expense)	(531,499)	(
Loss before income tax expense	(3,261,844)	(2,
(Benefit) provision for income taxes	-	
Net loss	$(3,261,844)	$(2,
Basic and diluted net loss per share	$(0.30)	
Weighted average shares outstanding--Basic and Diluted	10,724,308	8,

See accompanying notes.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Six Months Ended December 31,	
	2001 (Unaudited)	2 (Unau
Revenues:		
Franchise development	$112,247	$2
Royalties	5,610,685	6,4
Manufacturing and distribution	4,055,832	3,6
Company centers	829,309	1,1
Other	142,356	
Total revenues	10,750,429	11,7
Direct costs:		
Royalties	4,876,087	6,3
Manufacturing and distribution	3,458,931	2,8
Total direct cost	8,335,018	9,2
Contribution (exclusive of amortization shown separately below)	2,415,411	2,4
General and administrative expense	3,298,172	4,1
Depreciation expense	429,606	5
Amortization of franchise rights and goodwill	681,900	9
Charge for impairment of capitalized software	202,909	
Charge for impairment of goodwill	1,893,735	
Operating loss	(4,090,911)	(3,1
Other income (expense):		
Interest expense	(1,060,612)	(1,5
Interest income	6,643	
	(4,480)	(
Other		
Total other	(1,058,449)	(1,6
(expense)		
Loss before income tax expense	(5,149,360)	(4,7

(Benefit) provision for income taxes	- -	
Net loss	$(5,149,360) ============	$(4,7 ======
Basic and diluted net loss per share	$(0.50)	
Weighted average shares outstanding--Basic and Diluted	10,369,799	7,7

See accompanying notes.

PRECISION AUTO CARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	S 2001 (Unaudi --------
Operating activities:	
Net loss.	$(5,
Adjustments to reconcile net (loss) to net cash provided by operating activities:	
Depreciation and amortization.	1,
Amortization of debt discount.	
Stock issued for compensation.	
Charge for impairment of capitalized software.	
Charge for impairment of goodwill.	1,
Services received in exchange for stock	
Changes in operating assets and liabilities:	
Accounts and notes receivable.	(
Inventory.	(
Other assets.	
Assets held for sale.	
Accounts payable and accrued liabilities	2,

Deferred revenue and other

Net cash provided by (used in) operating activities
Investing activities:
Purchases of property and equipment.

Sale of property and equipment

Net cash (used in) provided by investing activities

Financing activities:
Proceeds from exercise of warrants.
Issuance of company stock.
Repayments of bank facility

Proceeds from note payable

Repayments of subordinated debt (

Repayment of mortgage notes and other notes payable (

Net cash used in financing activities

Net change in cash and cash equivalents
Cash and cash equivalents at beginning of year.

Cash and cash equivalents at end of period. $

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 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 US GAAP for complete financial statements. Certain amounts on the FY2001 financial statements have been reclassed to be in conformity with the FY2002 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-K/A for the year ended June 30, 2001.

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 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. Significant intercompany accounts and transactions have been eliminated in consolidation.

Note 2 - New Accounting Pronouncements

In June 2001, the FASB issued SFAS No. 141, "Business Combinations", which supercedes Accounting Principles Board ("APB") Opinion No. 16, "Business Combinations". SFAS 141 eliminates the pooling of interests method of accounting for business combinations and modifies the application of the purchase accounting method. The elimination of the pooling of interests method is effective for transactions initiated after June 30, 2001. The remaining provisions of SFAS 141 will be effective for transactions accounted for using the purchase method that are completed after June 30, 2001. The Company believes that the adoption of SFAS 141 will not have a material impact on the financial position or the results of operations of the Company.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Intangible Assets", which supercedes Accounting Principles Board ("APB") Opinion No. 17, "Intangible Assets". SFAS 142 eliminates the current requirement to amortize goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with a defined life and addresses the impairment testing and recognition for goodwill and intangible assets. SFAS 142 will apply goodwill and intangible assets arising from transactions completed before and after the Statement's effective date. Management intends to adopt SFAS No. 142 for fiscal year 2003.

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 (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. The weighted average number of shares outstanding related to the stock options and warrants at December 31, 2001 was 1,458,179. For the six months ended December 31, 2001 and 2000, the assumed exercises of the Company's outstanding stock options is not included in the calculation as the effect would be anti-dilutive.

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

	Six Months Ended December 31,	
	2001	2000
Earnings per share computation - basic and diluted		
Net loss..	$(5,149,360)	$(4,771,054)
Weighted average shares outstanding.............	10,369,799	7,762,873
Net loss per share- basic and diluted...............	$(0.50)	$(0.61)

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Note 4 - Inventory

The components of inventory are as follows:

	December 31, 2001	June 30, 2001
Raw materials....................................	$1,077,396	$927,679
Work-in-process..................................	329,066	206,050
Finished goods...................................	866,436	872,503
Reserve for obsolete and unsaleable inventory.....	-	(213,770)
	$2,272,898	$1,792,462

Note 5 - Debt

Senior Debt

On September 29, 2000 the Company issued senior debentures to Precision Funding, LLC, an entity owned and operated by Arthur C. Kellar and Desarollo Integrado, S.A. de C.V, an entity controlled by Mauricio Zambrano. Pursuant to the commitment made by Arthur C. Kellar and Desarollo Integrado, S.A. de C.V. on August 3, 2000, Precision Funding made available a credit facility of $11.25 million bearing interest at a fixed rate of 12% per annum with provisions for higher rates in the event of a default, and is to mature on September 1, 2003, if not paid prior to that time. Substantially all assets of the Company have been pledged as collateral and the Company may not pay any dividends without the written consent of Precision Funding. Precision Funding used the facility to purchase the Loan documents on the Bank Facility provided by First Union National Bank. A bridge loan that was made on August 4, 2000 by Arthur C. Kellar and to Desarollo Integrado, S.A. de C.V. was refinanced under the new credit facility. The Company used $991,000 of the new credit facility to repay a mortgage payable to FFCA. In connection with extending the credit

facility, an origination fee was paid to the Lenders in the form of a warrant entitling them to purchase 2,000,000 shares of common stock at an exercise price of $0.275 per share. A valuation was performed on the debt and warrants issued in connection with obtaining the new credit facility. The relative fair market value allocated to the warrants of approximately $651,000 has been recorded as paid in capital and a discount to the face value of the debt. The discount resulting from recording the value of the warrants is being amortized over the term of the debt agreement. The warrants were approved by the shareholders at the 2001 Annual Meeting held on March 21, 2001. In June 2001, Arthur C. Kellar exercised his right to purchase 1,000,000 shares and in July 2001, Falcon Solutions, Ltd., an entity controlled by Mauricio Zambrano, to which the rights had been assigned, purchased the remaining 1,000,000 shares.

On October 26, 2001, Precision Funding, LLC assigned its interest in the Company's trademarks, franchise agreements, and certain other assets to Precision Franchising, LLC. In connection with this assignment, the Company pledged all of its membership interest in Precision Franchising, LLC to Precision Funding, LLC as collateral security for the loan dated September 29, 2000.

Subordinated Debt

On October 15, 1998, the Company entered into a subordinated debenture with Board LLC, which was organized and funded by substantially all of the Directors of the Company for the sole purpose of providing additional financing to the Company. Under the terms of the agreement, the Company received $2 million and was to make monthly interest payments at an annual rate of 14% with the principal to be paid at the end of the loan term of twelve months. The terms of the subordinated debt call for increases in the interest rate if the Company defaults in the timely payment of interest on the subordinated debt. The Company is not permitted to make any payment with respect to the subordinated debt during the continuance of a default or event of default under the Senior Lender Funding Facility. As a result of a combination of defaults under the Bank Facility and the Company's failure to make interest payments on the subordinated debt, the debt has accrued interest at 16% per annum from the date of its issuance through August 15, 1999. The Board LLC had approved the waiver of existing events of default and the extension of the maturity date on such debt to November 1, 2000 and the interest rate returned to 14% effective August 15, 1999. Subsequent to June 30, 2000 Board LLC extended the maturity date of the subordinated debenture and waived all defaults under the agreement through September 30, 2001. In February 2001, the Company renegotiated the loan agreement with the Board LLC. All of the interest of approximately $407,000 that had been accrued up to that point was waived and has been reflected as an extraordinary item in the March 2001 statement of operations. Under the terms of the new agreement, the Company agreed to make monthly payments through December 2003. The effective interest rate for the new agreement was 8.68% per annum.

On January 25, 1999, the Company consummated a subordinated debt financing with a shareholder/director in the principal amount of $5,000,000. This subordinated debenture bears interest at 15% per annum, with provisions for higher rates in the event of default, and was to mature on May 25, 1999, if not paid prior to that time. Interest and a one point origination fee were paid in shares of the Company's common stock valued at the closing price on the day prior the original principal due date. The principal and interest

for the subordinated debenture may only be paid if the Company has made all required payments to the Senior Lender as set forth above and the Company is not in default on the Precision Funding credit facility. As of June 30, 2000, the Company had repaid $1.4 million of the debt. The Company received from the

holder of $3.6 million in subordinated debt a waiver of existing events of default and an extension of the maturity date to April 15, 2001. Subsequent to June 30, 2000 and 2001 the Company received further extensions of the maturity date through September 30, 2001 and January 1, 2003, respectively.

On November 28, 2001, the Company consummated subordinated debt financing agreements with two shareholder/directors in the principal amounts of $156,000 and $229,000, respectively. Each subordinated debenture bears interest at 10% per annum, with provisions for higher rates in the event of default, and is to mature on March 31, 2002, if not paid prior to that time.

Mortgage Notes Payable

On May 17, 1999, the Company executed nineteen promissory notes totaling $7,204,000, with FFCA Acquisition Corporation. Each note accrues interest at a rate of 9.9% per annum and matures 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%. On October 2, 2000, the mortgages were repaid.

Note 6 - Contingencies

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. At that time, management and its legal counsel believed that there were ample grounds for seeking appellate remedies by which, if granted, would result in a new trial. Subsequent to such date, motions for a new trial were not granted, and in June 2000, the Company was required to post a surety bond to appeal the case. Management concluded, in consultation with the Company's new internal counsel, that such developments had adversely affected the assessment of the outcome of this matter. Accordingly, in the fourth quarter of fiscal year 2000, the Company recorded an accrual of the jury verdict and estimated legal costs of approximately $1 million and included such amount in other operating expense in the consolidated statement of operations. 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.

A subsidiary of the Company was party to a confessed judgment of approximately $1.3 million. The subsidiary is currently inactive and has no assets. As such, management believes this judgment will have no material impact on the Company's consolidated results of operations.

In December 2000, the Company was named in a lawsuit seeking $15,000,000 damages arising out of a 1998 acquisition agreement. On November 14, 2001, the parties agreed to settle the case for $37,500 with the parties agreeing to mutual releases and with the Company retaining the right to proceed against the collateral securing a $500,000 loan guaranteed by the principal stockholders of Paisa, contingent on court approval. The court has approved the settlement and the Company has paid the full amount due under the settlement agreement.

On April 10, 2000, a landlord filed suit against a subsidiary of the Company for moneys due under a lease signed by one of its subsidiaries, seeking damages of more than $45,000. The Court entered summary judgment against the subsidiary by the Court in the amount of $54,000 plus interest and costs of $1,600. The claim was settled in December 2001 with the Company's payment of $10,000 in cash and a promissory jointly signed by the Company to pay an additional $15,000 in 15 monthly installments of $1,000 beginning January 1, 2002.

In November 2000, a landlord filed suit against the Company for moneys due under a lease signed by one of its subsidiaries, seeking damages of $234,000 plus attorneys fees. On January 19, 2001, the Company and its subsidiary filed an answer and affirmative defenses. The Court granted summary judgment in favor of Precision Auto Care, Inc., but reversed itself in January 2002. In February 2002, the parties agreed in principle to settle the case with PTAC's payment of $15,000 in cash and agreeing to pay an additional $25,000 payable over 6 months.

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 recorded reserves 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 have a material impact on the Company's financial position and results of operations.

Note 7 - Segment Information

For the quarter ended September 30, 2001 and thereafter, the Company has implemented the provision of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" as the Chief Operating Decision Maker (CODM) began evaluating the Company's operations along its two business lines: Automotive Care Franchising and Manufacturing and Distribution. The automotive care division, which is comprised of Precision Tune Auto Care and Precision Lube Express, provides automotive services primarily through franchised operations located in the United States and in certain foreign countries. As the end customer is the automotive consumer and the method of providing services is via the franchise system, the Company aggregated the financial results for Precision Tune Auto Care and Precision Lube Express entities. The Company's manufacturing and distribution division, which includes PBSI, Hydrospray, and World Wide Dryer produces modular buildings and car wash equipment. PBSI, Hydrospray, and World Wide Dryer are manufacturing entities producing the aforementioned products as opposed to rendering services which are provided by the Automotive Care division. Given that all three entities are manufacturing businesses, the Company made the decision to aggregate their financial results into a distinct segment. There were no sales between the two segments. Precision Lube Express franchises did not buy any Hydrospray products. The chief operating decision maker evaluates the performance of the Company's operating segments based upon contribution margin, which includes all direct costs associated with the operations of such businesses. Certain expenses such as corporate general and administrative costs, other operating costs and non-recurring charges, which are managed and evaluated outside of the operating segments, are excluded. The information that is presented below is for the six months ended December 31, 2001. A new CEO, Lou Brown and a new CFO, Robert Falconi were hired by the Company during FY01. The new CFO upgraded the accounting staff, had new accounting software installed and made numerous other changes in accounting processes and procedures so that the Company would be able to collect accurate financial information by business segment. Prior to the quarter ending September 30, 2001, information was evaluated by the CODM and reviewed with the Board of

Directors solely at the consolidated level.

A summary of the segment financial information is as follows:

	Six Months Ended December 31,	
	2001	2000
Revenues:		
Automotive Care Franchising	$5,722,932	$6,738,4
Manufacturing & Distribution	4,055,832	3,691,6
Total segment revenues	9,778,764	10,430,1
Other	971,665	1,297,0
Total revenues	$10,750,429	$11,727,1
Contribution:		
Automotive Care Franchising	$1,627,300	$1,653,5
Manufacturing & Distribution	596,901	837,3
Total segment contribution	2,224,201	2,490,9
Other	191,210	(6,6
Total contribution	$2,415,411	$2,484,2
Assets:		
Automotive Care Franchising	$13,314,929	$34,342,4
Manufacturing & Distribution	4,264,197	3,566,0
Total assets	$17,579,126	$37,908,5

Capital expenditures:

Automotive Care Franchising	$51,732
Manufacturing and Distribution	29,844
Total Capital Expenditures	$81,576

Reconciliation of segment contribution to net income before income taxes:

Automotive Care Franchising	$1,627,300
Manufacturing & Distribution	596,901
Total segment contribution	2,224,201
Other	191,210
Total contribution	2,415,411
General & administrative expense	3,298,172
Depreciation expense	429,606
Amortization expense	681,900
Charge for impairment of capitalized software	202,909
Charge for impairment of goodwill	1,893,735
Other expenses	1,058,449
Net income (loss) before income taxes	$(5,149,360)

Note 8 - Subsequent Events

The Company sold assets owned by its Mexican subsidiary for $1.8 million in January 2002, of which $350,000 is contingent upon certain events outside the company's control. In addition, the company entered into a technical service agreement with the buyer in return for a non-refundable payment of $900,000. The tangible assets involved in this sale are included in assets held for sale as of December 31, 2001. The Company will recognize the revenue from the technical services agreement in future periods. The proceeds of the sale are earmarked to pay interest on the Company's senior debt and to liquidate other liabilities.

In January 2002, the Company sold a building owned by one of its manufacturing subsidiaries for $660,000 to a related party, a partnership which includes Ernie Malas, the manager of the Hydrospray subsidiary, and subsequently leased back the property. One year of prepaid rent was netted against the sales proceeds.

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, 2001 to the three months ended December 31, 2000

Summary (in thousands)

	2001	%	2000	%
Automotive car franchising revenue	$2,700	54	$3,259	59
Manufacturing & distribution revenue	1,779	36	1,790	33
Other	478	10	449	8
Total revenues	$4,957	100%	$5,498	100
Automotive care franchising direct cost.	$2,004	40	$2,563	46
Manufacturing & distribution direct cost.	1,532	31	1,360	25
Other	389	8	443	8
Total direct cost.	$3,925	79	$4,366	79
General and administrative	1,930	39	1,867	34
Charge for impairment of capitalized software	203	4	-	0
Charge for impairment of goodwill	1,100	22	-	0
Operating (loss)	(2,730)	(55)	(1,444)	(26
Other	532	11	634	12
Net loss	(3,262)	(66)	(2,107)	(38

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Revenue. Total revenues for the three months ending December 31, 2001 was $4.9 million, a decrease of approximately $541,000, or 10%, compared with total revenues of $5.5 million for the corresponding period of the prior year.

Automotive care franchising revenue for the three months ending December 31, 2001 was $2.7 million, a decrease of approximately $559,000, or 17%, compared with automotive care revenues of $3.3 million for the corresponding period of the prior year. The decrease was primarily the result of a decrease in royalty revenues. Royalty revenues were down as a result of fewer franchise centers from the prior year.

Manufacturing and distribution revenue for the three months ending December 31, 2001 was $1.8 million, a decrease of approximately $11,000, or 1%, compared with manufacturing and distribution revenues of $1.8 million for the corresponding period of the prior year.

Other revenue for the three months ending December 31, 2001 was $478,000, an increase of approximately $29,000, or 6%, compared with other revenues of $449,000 for the corresponding period of the prior year.

Direct Cost. Total direct costs for the three months ending December 31, 2001 totaled $3.9 million, a decrease of $441,000 or 10%, compared with $4.4 million for the corresponding period of the prior year.

Automotive care franchising direct costs for the three months ending December 31, 2001 totaled $2.0 million, a decrease of $559,000 or 22%, compared with $2.6

million for the corresponding period of the prior year. The decrease is attributable to cost decreases in royalty of $517,000 and franchise development of $42,000. This is consistent with the lower sales the Company has experienced in royalty and franchise development.

Manufacturing and distribution direct costs for the three months ending December 31, 2001 totaled $1.5 million, an increase of $172,000 or 13%, compared with $1.3 million for the corresponding period of the prior year. This is attributable to the increase cost of certain manufacturing components.

Other direct costs for the three months ending December 31, 2001 totaled $389,000, a decrease of $54,000 or 12%, compared with $443,000 for the corresponding period of the prior year. The decrease is consistent with the lower sales the Company has experienced in company centers.

General and Administrative Expense. General and administrative expense was $1.9 million for the three months ending December 31, 2001, an increase of $63,000 or 3%, compared with $1.8 million for the quarter ending December 31, 2000. This is the primary result of the legal and accounting costs associated with the sale of the Company's Mexican subsidiary.

Impairment of Capitalized Software. The Company recognized a $203,000 impairment charge for a point of sale software system when it was determined by management that the system was no longer useful.

Impairment of Goodwill. The Company recognized a $1.1 million impairment charge to reduce the amount of goodwill attributed to the company's Mexican subsidiary. In May 2001, the Company was approached by an outside investor who expressed an interest in purchasing the company's Mexican subsidiary. The proposed purchase price offered by the prospective buyer lead to internal discussion regarding the appropriateness of the current carrying value of goodwill relating to this entity. After completing analysis on the operations, it was clear that because of the subsidiary's declining revenues and significant decrease in profitability, it was appropriate and necessary to record an impairment charge. Subsequent to June 30, 2001, the outside investor performed due diligence and revised their offer. The revised offer led to further analysis on operations and the decision to record an additional impairment charge of $793,000 in the three months ending September 30, 2001. In January 2002, the Company sold assets owned by its Mexican subsidiary for $1.8 million, of which $350,000 is contingent upon certain events outside the company's control. In addition, the company entered into a technical service agreement with the buyer in return for a non-refundable payment of $900,000. The tangible assets involved in this sale are included in assets held for sale as of December 31, 2001. The Company will recognize the revenue from the technical services agreement in future . Because the final negotiations with the outside investor further reduced the purchase price from what had previously been anticipated, , an additional impairment charge of $1.1 million was subsequently taken in the three months ending December 31, 2001.

Operating (Loss). The Company recorded an operating loss for the three months ending December 31, 2001 of $2.7 million, which represents an increase in operating loss of $1.3 million or 89% compared with an operating loss of $1.4 million for the corresponding period of the prior year.

Other Income (Expense). The Company recorded Other Expense of $532,000 for the three months ending December 31, 2001 which represents a decrease in Other Expense of $103,000 or 16% compared to the Other Expense for the corresponding

period of the prior year. The decrease was primarily attributable to a decrease in interest expense. The new financing that the Company obtained with Precision Funding provided for better terms than the previous financing arrangement with First Union and enabled the Company to save money on interest expense.

Net Loss. The Company recorded a Net Loss of $3.3 million for the three months ending December 31, 2001. This represents an increase of $1.1 million or 55% compared to the Net Loss for the corresponding period of the prior year. The increase was primarily attributable to the increase in the operating loss of $1.3 million, offset in part by a reduction in interest expense of $110,000.

Comparison of the six months ended December 31, 2001 to the six months ended December 31, 2000

Summary (in thousands)

	2001	%	2000
Automotive car franchising revenue.................	$5,724	53	$6,739
Manufacturing & distribution revenue...............	4,055	38	3,691
Other...	971	9	1,297
Total revenues....................................	$10,750	100%	$11,727
Automotive care franchising direct cost............	$4,096	38	$5,084
Manufacturing & distribution direct cost...........	3,459	32	2,854
Other...	780	7	1,304
Total direct cost..................................	$8,335	78	$9,242
General and administrative.........................	3,298	31	4,131
Charge for impairment of capitalized software.......	203	2	-
Charge for impairment of goodwill..................	1,894	18	-
Operating (loss)..................................	(4,091)	(38)	(3,148)
Other...	1,058	10	1,623
Net loss..	(5,149)	(48)	(4,771)

Revenue. Total revenues for the six months ending December 31, 2001 was $10.8 million, a decrease of approximately $977,000, or 8%, compared with total revenues of $11.7 million for the corresponding period of the prior year.

Automotive care franchising revenue for the six months ending December 31, 2001 was $5.7 million, a decrease of approximately $1.0 million, or 15%, compared with automotive care revenues of $6.7 million for the corresponding period of the prior year. The decrease was primarily the result of a decrease in royalty revenues. Royalty revenues were down as a result of fewer franchise centers from the prior year.

Manufacturing and distribution revenue for the six months ending December 31, 2001 was $4.0 million, an increase of approximately $364,000, or 10%, compared with manufacturing and distribution revenues of $3.6 million for the corresponding period of the prior year. The increase in manufacturing and distribution revenue is the result of increased sales in its car wash

manufacturing subsidiary.

Other revenue for the six months ending December 31, 2001 was $971,000, a decrease of approximately $326,000, or 25%, compared with other revenues of $1.3 million for the corresponding period of the prior year. The decrease was primarily the result of decreases in retail sales from Company stores of $370,000. The decrease in company store revenues is a result of the disposition of all domestically owned car care centers. These decreases were partially offset by an increase in other income of $44,000.

Direct Cost. Total direct costs for the six months ending December 31, 2001 totaled $8.3 million, a decrease of $907,000 or 10%, compared with $9.2 million for the corresponding period of the prior year.

Automotive care franchising direct costs for the six months ending December 31, 2001 totaled $4.1 million, a decrease of $988,000 or 19%, compared with $5.1 million for the corresponding period of the prior year. The decrease is attributable to cost decreases in royalty of $821,000 and franchise development of $167,000. This is consistent with the lower sales the Company has experienced in royalty and franchise development.

Manufacturing and distribution direct costs for the six months ending December 31, 2001 totaled $3.5 million, an increase of $605,000 or 21%, compared with $2.8 million for the corresponding period of the prior year. This is consistent with the higher sales the Company experienced from the corresponding period of the prior year and deteriorating margins.

Other direct costs for the six months ending December 31, 2001 totaled $780,000, a decrease of $524,000 or 40%, compared with $1.3 million for the corresponding period of the prior year. The decrease is attributable to cost decreases in company centers of $479,000 and other of $45,000. This is consistent with the lower sales the Company has experienced in company centers.

General and Administrative Expense. General and administrative expense was $3.3 million for the six months ending December 31, 2001, a decrease of $833,000 or 20%, compared with $4.1 million for the six months ending December 31, 2000. This is the primary result of management's cost reduction initiatives.

Impairment of Capitalized Software. The Company recognized a $203,000 impairment charge for a point of sale software system when it was determined by management that the system was no longer going to be utilized. .

Impairment of Goodwill. The Company recognized a $1.9 million impairment charge to reduce the amount of goodwill attributed to the company's Mexican subsidiary. In May 2001, the Company was approached by an outside investor who expressed an interest in purchasing the company's Mexican subsidiary. The proposed purchase price offered by the prospective buyer lead to internal discussion regarding the appropriateness of the current carrying value of goodwill relating to this entity. After completing analysis on the operations, it was clear that because of the subsidiary's declining revenues and significant decrease in profitability, it was appropriate and necessary to record an impairment charge. Subsequent to June 30, 2001, the outside investor performed due diligence and revised their offer. The revised offer led to further analysis on operations and the decision to record an initial impairment charge of $793,000 in the three months ending September 30, 2001. In January 2002, the Company sold the assets owned by its Mexican subsidiary for $1.8 million, of which $350,000 is

contingent upon certain events outside the company's control. In addition, the company entered into a technical service agreement with the buyer in return for a non-refundable payment of $900,000. The tangible assets involved in this sale are included in assets held for sale as of December 31, 2001. The Company will recognize the revenue from the technical services agreement in future periods. Because the final negotiations with the outside investor reduced the purchase price from what had previously been anticipated , an additional impairment charge of $1.1 million was subsequently taken in the three months ending December 31, 2001.

Operating (Loss). The Company recorded an operating loss for the six months ending December 31, 2001 of $4.1 million, which represents an increase in operating loss of $943,000 or 30% compared with an operating loss of $3.1 million for the corresponding period of the prior year.

Other Income (Expense). The Company recorded Other Expense of $1.1 million for the six months ending December 31, 2001 which represents a decrease in Other Expense of $592,000 or 36% compared to the Other Expense for the corresponding period of the prior year. The decrease was primarily attributable to a decrease in interest expense. The new financing that the Company obtained with Precision Funding provided for better terms than the previous financing arrangement with First Union and enabled the Company to save money on interest expense.

Net Loss. The Company recorded a Net Loss of $5.2 million for the six months ending December 31, 2001. This represents an increase of $378,000 or 8% compared to the Net Loss for the corresponding period of the prior year.

Liquidity and Capital Resources

Sources and Uses of Cash

Cash at December 31, 2001 was $316,000. This was a decrease of $29,000 from June 30, 2001. During the period, cash provided by operations was $26,000. The Company expects to be able to meet all of its operating obligations by reductions in operating expenses, improved collections, improved inventory management, and the sale of certain assets. At this time, the Company can not anticipate when it will be able to sell World Wide Dryer because of the lack of interest to date, and if there continues to be no interest in the very near term, the Company may decide to merge World Wide Dryer with Hydrospray. In the event that the Company has difficulty in meeting obligations, the Company expects that they will be able to borrow money from certain shareholders and/or officers on a short-term basis. In February, the SEC declared the company's Rights Offering effective. The Company expects to raise enough money from the rights offering to enable it to exercise its business plan.

Cash used in investing activities for the six months ended December 31, 2001 was $32,000. The cash used in investing activities was primarily the result of purchases of property and equipment. In January 2002, the Company sold assets owned by its Mexican subsidiary for $1.8 million, of which $350,000 is contingent upon certain events outside the company's control. In addition, the company entered into a technical service agreement with the buyer in return for a non-refundable payment of $900,000. Proceeds of the sale are earmarked to pay interest on the Company's senior debt and to liquidate other liabilities. In January 2002, the Company sold a building owned by one of its manufacturing subsidiaries to a related party, a partnership that includes Ernie Malas, the manager of the Hydrospray subsidiary, for $660,000 and subsequently leased back the property. One year of prepaid rent was included in the sales proceeds.

Cash used in financing activities for the six months ended December 31, 2001 was $23,000. Cash provided by financing activities during the period included the sale of common stock of $275,000 and the issuance of subordinated debt financing agreements with two shareholder/directors in the principal amounts of $156,000 and $229,000. This infusion of cash was offset by repayments of mortgages, the subordinated debt and other notes payable of $683,000.

Debt Transactions

During fiscal year 2001, the Company was successful in obtaining a new source of financing. 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 September 2001, Precision Funding agreed to allow the Company to defer the interest payment that is due in September, 2001 until July 1, 2002.

On October 26, 2001, Precision Funding, LLC, assigned its interest in the Company's trademarks and certain other assets relating to the franchising operations to Precision Franchising, LLC, a wholly owned subsidiary of the Company. In connection with this assignment, the Company pledged all of its membership interest in Precision Franchising, LLC to Precision Funding LLC as collateral for the loan dated September 29, 2000.

In addition to the credit facility with Precision Funding LLC, the Company has two outstanding subordinated debenture agreements. Under the terms of each subordinated debenture, payments of principal and interest on certain of the subordinated debt may only be made by the Company if the Company has made all required payments to Precision Funding or is otherwise not in default under that credit facility.

The first subordinated debenture in the amount of $2.0 million was executed in October 1998 with an LLC composed of certain members of the Company's board of directors (Board LLC). Originally due October 15, 1999, the maturity of the subordinated debenture was extended until September 30, 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 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 September 30, 2001.

In February 2001, the Company renegotiated the terms of the subordinated debenture with the Board LLC composed of certain members of the Company's board of directors. Under the terms of the renegotiation, Board LLC agreed to waive all of the $407,000 of interest that had been accrued to date. In exchange, the Company agreed to begin making payments to Board LLC so that the Board LLC would be completely paid by May 2002. Precision Funding LLC agreed to the terms of the renegotiation.

The second subordinated debenture in the amount of $5.0 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 has been extended to January 1, 2003. The holder also waived all debt covenants through January 1, 2003.

On May 17, 1999, the Company executed nineteen promissory notes totaling $7.2 million, 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 that had a maturity date of 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. During fiscal year 2001 the Company repaid all of this debt with proceeds from sales of car wash and lube centers (see discussion above).

On November 28, 2001, the Company consummated subordinated debt financing agreements with two shareholder/directors in the principal amounts of $156,000 and $229,000, respectively. Each subordinated debenture bears interest at 10% per annum, with provisions for higher rates in the event of default, and is to mature on March 31, 2002, if not paid prior to that time.

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 operations, particularly the manufacturing and distribution business in the U.S. However, with the refinancing, reductions in expenses, improved collections, improved inventory management, and the sale of certain assets, the Company expects to be able to meet all of its financial obligations and be able to focus on growing and improving profitability of its franchising and manufacturing businesses.

Seasonality and Quarterly Fluctuations

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 and Precision Lube Express centers. Severe winter weather and rainy conditions may also adversely impact the Company's sale and installation of car wash equipment.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS

At December 31, 2001 the Company did not have market risk exposure as interest rates for all of its outstanding debt were fixed.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is subject to litigation that could have a material adverse impact on its liquidity as follows:

<u>Precision Tune Auto Care, Inc. v. Andhras Corporation, Rambal Anne, Chad Anne and Sunitha Anne, U. S. District Court, Eastern District of Virginia, Alexandria Division, Civil Action No. 01-0095-A.</u>

On January 19, 2001, Precision Tune Auto Care, Inc., ("PTAC") filed suit against Andhras Corporation ("Andhras") and its stockholders for moneys owed under 6 franchise agreements totaling over $430,000. On May 15, 2001, Andhras and Rambal Anne filed an Answer and Counterclaim alleging that PTAC breached a settlement

agreement that the parties signed in 1998 by converting a Lube Depot located within 1.5 miles of one of Andhras' franchised locations to a Precision brand center, violated the Indiana Franchise Deceptive Practice Act by operating a company-owned center within the exclusive territory of Andhras, and violated the franchise agreements by failing to take action against unknown owners to enjoin use of "Precision Auto Care" in connection with 2 auto repair centers located near Andhras' franchised locations in Indiana. On June 27, 2001, PTAC filed an answer denying the allegations made in the Counterclaim. In February 2002, the parties agreed in principle to settle the case with Andhras agreeing to a stipulated judgment of $315,000 and to dismiss the counter claim with prejudice. PTAC agreed to dismiss the claims against Chad Anne and Sonata Anne based on their representations that they had no assets. In addition, Ramble Anne, who had filed for protection under Chapter 13 of the U.S. Bankruptcy Code agreed not to oppose PTAC's claim in the amount of $315,000.

<u>Bonneville Car Wash Systems, Inc. and Ivory Enterprises, Inc. v. Precision Auto Care, Inc. dba Precision and Hydrospray, Third Judicial District, District Court for Salt Lake County, Utah. Civil Case Number 99-090-6889</u>

Bonneville, a distributor of Hydro Spray Car Wash Equipment Co., Ltd. and its related corporation sued PACI and Hydro Spray on July 8, 1999. The plaintiffs allege that the defendants made fraudulent representations in connection with the sale of certain equipment manufactured by Hydro Spray and sold it to Ivory, made intentional misrepresentations, breeched the warranty of merchantability, breached various contracts with the plaintiffs and tortiously interfered with Bonneville's business relationships with existing customers. The plaintiff seeks actual damages in excess of $515,000, punitive damages and attorney's fees. The defendants filed an answer denying the allegations on August 18, 1999. The court has not yet scheduled a trial date.

<u>Performance Concepts, Inc. and James E. Radcliffe v. Precision Tune Auto Care, Inc., (Circuit Court, 17th Judicial Circuit, Broward County, Florida, Case No. 98-007130 (03) filed May 4, 1998).</u>

In response to PTAC's notice of termination of plaintiff's franchise agreement due to certain acts of plaintiff expressly prohibited by the franchise agreement, Plaintiff filed suit seeking a temporary injunction to enjoin PTAC from terminating plaintiff's franchise agreement and alleging the following that PTAC breach its contract with the plaintiffs, breached the covenant of good faith and fair dealing, tortiously interfered with business relationship, and slandered the plaintiffs. The plaintiffs sought unspecified damages in excess of $15,000 plus punitive damages. On June 3, 1998, the court granted a temporary injunction enjoining both parties from violating the franchise contract. In a counterclaim filed August 6, 1998, PTAC demanded indemnification under the franchise agreement by both plaintiffs for certain of the allegations, which has been agreed to by plaintiffs' insurance carrier. On August 26, 1998, counter-plaintiffs filed a motion to dismiss the counterclaim. In October 1999, the plaintiffs filed Motions for Sanctions for failure to comply with a request for documentation and failure to supply most knowledgeable corporate representatives for deposition. In November 1999, plaintiff filed a Second Motion for Sanctions, seeking to strike PTAC's pleadings, including the Counterclaim. On November 15, 1999, the court granted the motion to strike PTAC's pleadings and on November 24, 1999, the court entered an order striking PTAC's pleadings and entering a default, ruling that the allegations of the Plaintiff's Complaint would be deemed admitted and that the only issue for trial was the amount of damages sustained. On March 21, 2000, a jury awarded Plaintiff

damages in the amount of $841,000. PTAC has appealed the decision to the Fourth District Court of Appeals. PTAC filed its appellate brief on January 5, 2001. On November 14, 2001, the Court ruled that the trial court erred in allowing the plaintiff to obtain damages based on other franchise agreements that were not pleaded in the complaint, and remanded the case back to the trial court for another hearing on damages. PTAC filed a motion for rehearing seeking a complete reversal of the trial court decision, which was denied in February, 2002. The trial court has not yet scheduled a new trial on the issue of damages.

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Anwar Meherally, Shan Meherally, A. M. Enterprises, Inc., Shanwar WA, Inc. and Car Tune, Inc. v. Precision Auto Care, Inc., Precision Tune Auto Care, Inc., and PTW, Inc., Superior Court of the State of Washington for the County of King, Case No. 00-2-13974-8SEA

On May 11, 2000, the plaintiffs filed suit against the Company alleging that a 1998 settlement agreement of a prior lawsuit was voidable because it was obtained through fraud, misrepresentation, and the malicious application of economic duress, that the defendants' actions constituted a failure to act in good faith as required by the Washington Franchise Investment Protection Act, that the defendants violated the implied covenant of good faith and fair dealing in both the area agreement and the settlement agreement, that the defendants' actions violated the Washington Franchise Investment Protection Act, and that the defendants used instrumentalities of interstate commerce in carrying out concerted actions in violation of the Racketeer Influenced and Corrupt Organizations Act. The plaintiffs seek damages in excess of $5 million (to be trebled under the Washington Franchise Investment Protection Act), attorneys' fees, rescission of the settlement agreement, injunctive relief prohibiting the defendants from stopping the payment of royalties to the plaintiffs under the area agreement and other relief. The defendants filed responsive pleadings. The defendants also filed a motion for summary judgment seeking dismissal of the lawsuit based on the 1998 settlement agreement of the prior lawsuit. On October 29, 2001, the Court entered an Order granting the defendants' motion for summary judgment in part, dismissing the claims seek to avoid or rescind the 1998 settlement agreement and dismissing the claims alleging violation of the Washington Franchise Investment Protection Act and the RICO Act and denying the defendants' motion for summary judgment regarding the plaintiffs claims that the defendants' breached the settlement agreement and other claims (sounding in good faith and fair dealing). On November 8, 2001, the plaintiffs filed a motion for clarification of the Order entered on October 29, 2001, which motion is still pending . Trial is currently scheduled to begin on April 1, 2002.

Precision Tune Auto Care, Inc. v. Shanwar WA, Inc., Shanwar, Inc., Car Tune, Inc., Anwar Meherally and Shahnaz A. Meherally, Civil Action No. 01-1151-4 (U.S. District Court for the Eastern District of Virginia, filed July 26, 2001).

PTAC filed suit against Shanwar WA, Inc., its stockholders (Anwar Meherally and Shahnaz Meherally) and related corporations for unpaid franchise fees and trademark infringement arising out of the defendant's unauthorized use of PTAC's trademarks. On October 5, 2001, the Court denied the defendants' motion to dismiss PTAC's claims based on the priority of the Washington State action

referred to above, and instead ordered the action to proceed in federal court in Virginia. On October 15, 2001, the defendants filed an answer and affirmative defenses. On January 16, 2002, the Court granted PTAC's motion for partial summary judgment as to the defendant's liability. Trial is currently scheduled to determine the amount of the defendants' liability to PTAC on April 1, 2002.

Lawrence W. Frakes, and Teresa K. Frakes v. John Garies, William Grimaud, Grimaud Enterprises, Inc., Precision Tune Auto Care, Inc. f/d/b/a Precision Tune, Inc., Civil Action No. CV97-2126 (Circuit Court of Madison County, Alabama, filed November 3, 1997).

Plaintiffs allege that defendants orally made material misrepresentations about adequate capitalization, access to used equipment, support, and guarantees of expected earnings. Plaintiffs also allege that defendants breached their agreement, violated the Deceptive Trade Practices Act of Alabama and participated in a civil conspiracy to defraud. Plaintiffs are seeking judgment for unspecified compensatory and punitive damages. On December 22, 1997, defendants Garies, William Grimaud and PTAC filed motions to dismiss. On May 9, 2000, all defendants filed an Amended Motion to Dismiss. On April 26, 2001, PTAC filed a Second Amended Motion to Dismiss. The Court has scheduled a hearing on the defendants' motions to dismiss for November 15, 2001. The court has not yet ruled on the motions to dismiss, and no trial date has been scheduled.

Paisa, Inc. v. Precision Auto Care, Inc. , Case No. CV-99-0128R (United States District Court, Central District of California, Los Angeles, filed February 8, 1999).

Plaintiff alleged breach of contract relating to an alleged offer to purchase plaintiff, fraud by inducing plaintiff to accept a loan thereby placing plaintiff in a position of further financial detriment and indebtedness, and negligent misrepresentation by not informing plaintiff of defendant's financial difficulties. Plaintiff sought judgment for $15,000,000 consequential damages; court costs and attorneys' fees; and any other relief the Court might find proper. Plaintiff also sought injunctive relief against enforcement of their promissory note and security agreement with defendant. PACI filed an answer denying the allegations contained in the complaint. On April 6, 1999, a notice of voluntary dismissal without prejudice was filed by the plaintiff and granted by the Court. Paisa re-filed their complaint in the state court with the same allegations as above, Paisa v. Precision Auto Care, Inc., Case No. BC209390 (Superior Court of the State of California for the County of Los Angeles Central District filed April 27, 1999). On July 2, 1999, Plaintiff filed a voluntary Chapter 11 petition, later converted to a Chapter 7 liquidation. On November 11, 1999, the court dismissed this case without prejudice.

On November 20, 2000, Paisa, Inc., through the Chapter 7 Trustee, filed a complaint alleging breach of contract by failing to close on the acquisition of Paisa, Inc., seeking unspecified damages (Howard Grobstein, Chapter 7 Trustee v. Precision Auto Care, Inc., U. S. Bankruptcy Court, Central District of California). On January 5, 2001, PACI filed an answer denying the allegations in

the complaint and the case was transferred to the U.S. District Court, Central Division, Los Angeles Division (Civil Action No. 01-011176 ABC). On November 14, 2001, the parties agreed to settle the case by PACI's agreement to pay $37,500 to the bankruptcy estate, within 60 days after bankruptcy court approval, with the parties agreeing to mutual releases and with PACI retaining the right to proceed against the collateral securing a $500,000 loan guaranteed by the principal stockholders of Paisa, contingent on court approval. The court has approved the settlement and PACI has paid the full amount due under the settlement agreement.

Lorena Strickland v. Precision Tune Auto Care, Inc. and PTW, Inc., Case No. 00-2-28092-1-SEA, (Superior County, King County, Washington, filed November 7, 2000)

In November 2000, a landlord filed suit against the Company for moneys due under a lease signed by one of its subsidiaries, seeking damages of $234,000 plus attorneys fees. On January 19, 2001, the Company and its subsidiary filed an answer and affirmative defenses. The Court granted summary judgment in favor of Precision Auto Care, Inc., but reversed itself in January 2002. In February 2002, the parties agreed in principle to settle the case with PTAC's payment of $15,000 in cash and agreeing to pay an additional $25,000 payable over 6 months.

Landmark Development Group II v. PTW, Inc., Case No. 00-2-08158-8-KNT (Superior Court, King County, Washington, filed April 10, 2000).

On April 10, 2000, a landlord filed suit against one of the Company's subsidiaries for moneys due under a lease signed by its subsidiary, seeking damages of more than $45,000. The Court entered summary judgment against the subsidiary by the Court in the amount of $54,000 plus interest and costs of $1,600. The claim was settled in December 2001 with the subsidiary's payment of $10,000 in cash and a promissory jointly signed by the Company to pay an additional $15,000 in 15 monthly installments of $1,000 beginning January 1, 2002.

United Bank, NA v. C. Eugene Deal, Miracle Partners, Inc., and Star Auto Center, Inc. (Common Pleas Court, Crawford County, Ohio).

A subsidiary of the Company, was party to a confessed judgment of approximately $1.3 million. The subsidiary is currently inactive and has no assets.

Other than the Radcliffe case, the Company does not believe that any of the above litigation will result in material judgments against the Company. There can be no assurance, however, that these suits will ultimately be decided in its favor. Any one of these suits may result in a material judgment against the Company, which could cause material adverse consequences to its operations. Although the Company has a judgment against it in the Radcliffe case and the Company has reserved for that judgment, the Company believes that it will ultimately prevail against Radcliffe.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

On July 17, 2001, Falcon Solutions, Ltd. exercised a warrant to purchase 1,000,000 shares of common stock for $275,000. The proceeds were used to fund the Company's working capital.

On September 24, 2001, bonuses in the form of stock grants were granted to officers of the Company totaling $126,500.

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 5 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

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit No.	Description
None.	

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 February 14, 2002.

Precision Auto Care, Inc.

/s/ Louis M. Brown

By:
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	February 14

------------------	Officer and Director	
Louis M. Brown	(Principal Executive Officer)	
/s/ Robert R. Falconi	Senior Vice President and Chief	February 14
---------------------	Financial Officer (Principal	
Robert R. Falconi	Financial Accounting Officer)	

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