

# PRECISION AUTO CARE, INC.

A Virginia Corporation

## Quarterly Report

September 30, 2008

**Item I**            **Exact name of the issuer and the address of its principal executive offices.**

**A)            The exact name of the issuer and its predecessor.**

The name of the issuer is "Precision Auto Care, Inc." The issuer did not acquire capital or assets from a predecessor during the preceding five year period.

**B)            The address of the issuer's principal executive offices.**

Precision Auto Care, Inc.  
748 Miller Drive, S.E.,  
Leesburg, VA 20175  
Phone: (703) 777-9095  
Fax: (703) 771-7108  
Website: [www.precisiontune.com](http://www.precisiontune.com)

Investor Relations: Robert R. Falconi  
Phone: (703) 777-9095  
E-mail: [robert.falconi@precisionac.com](mailto:robert.falconi@precisionac.com)  
Address: Same as above

**Item II****Shares Outstanding.****A) The number of shares or total amount of the securities outstanding for each class of securities outstanding.**

Common Stock	
(i) Period End Date	September 30, 2008
(ii) Authorized	39,000,000
(iii) Issued and Outstanding	28,993,752
(iv) Freely tradable shares (public float)	6,320,190
(v) Number of shareholders of record	182
Class A Preferred Stock	
(i) Period End Date	September 30, 2008
(ii) Authorized	1,000,000
(iii) Issued and Outstanding	11,227
(iv) Freely tradable shares (public float)	-
(v) Number of shareholders of record	2

**PRECISION AUTO CARE, INC.**

**Consolidated Financial Statements  
as of  
September 30, 2008**

**PRECISION AUTO CARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	September 30, 2008	June 30, 2008
	(unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents .....	\$ 4,351,820	\$ 4,761,725
Accounts receivable, net of allowance of \$103,637 and \$113,148, respectively .....	425,706	517,068
Notes receivable, net of allowance of \$182,290 and \$183,729, respectively .....	84,998	75,176
Deferred tax asset .....	704,702	704,568
Other assets .....	<u>535,878</u>	<u>437,598</u>
Total current assets .....	6,103,104	6,496,135
Property and equipment, net .....	924,304	800,218
Goodwill .....	9,410,474	9,276,265
Notes receivable, net of allowance of \$213,584 and \$232,145, respectively .....	125,849	130,448
Deferred tax asset .....	4,597,787	4,596,905
Deposits and other .....	<u>132,329</u>	<u>106,024</u>
Total assets .....	<u>\$ 21,293,847</u>	<u>\$ 21,405,995</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Line-of-credit .....	\$ -	\$ -
Notes payable and capital lease obligation- current .....	67,829	82,476
Accounts payable and accrued liabilities .....	123,171	173,588
Taxes payable .....	666,036	668,136
Accrued commission payable .....	196,525	211,988
Accrued salaries and related expenses .....	442,086	453,136
Due to related party .....	137,200	160,556
Deferred revenue .....	<u>188,340</u>	<u>170,225</u>
Total current liabilities .....	1,821,187	1,920,105
Notes payable and capital lease obligation, net of current portion .....	<u>46,084</u>	<u>53,569</u>
Total liabilities .....	1,867,271	1,973,674
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 .....	67,816,821	67,816,821
Accumulated deficit .....	<u>(48,796,495)</u>	<u>(48,790,750)</u>
Total stockholders' equity .....	<u>19,310,264</u>	<u>19,316,009</u>
Total liabilities and stockholders' equity .....	<u>\$ 21,293,847</u>	<u>\$ 21,405,995</u>

See accompanying notes.

**PRECISION AUTO CARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Three Months Ended September 30,	
	2008 (unaudited)	2007 (unaudited)
Revenues:		
Franchise royalties .....	\$ 2,330,732	\$ 2,754,142
Franchise development .....	67,425	38,063
Company-operated retail stores .....	714,409	202,317
Other .....	<u>94,170</u>	<u>86,713</u>
Total revenues.....	3,206,736	3,081,235
Direct costs:		
Franchise support and other.....	1,754,966	1,804,549
Company-operated retail stores .....	<u>709,726</u>	<u>236,197</u>
Total direct costs.....	2,464,692	2,040,746
General and administrative expense .....	735,886	745,724
Depreciation and amortization expense.....	<u>35,976</u>	<u>17,548</u>
Operating (loss) income.....	(29,818)	277,217
Interest expense .....	(868)	(1,176)
Interest income.....	26,647	51,845
Other income .....	<u>1,132</u>	<u>614</u>
Total other income .....	<u>26,911</u>	<u>51,283</u>
(Loss) income before income tax expense.....	(2,907)	328,500
Provision for income taxes .....	<u>2,256</u>	<u>136,853</u>
Net (loss) income.....	(5,163)	191,647
Preferred stock dividends .....	<u>582</u>	<u>582</u>
Net (loss) income applicable to common shareholders .....	<u>\$ (5,745)</u>	<u>\$ 191,065</u>
Net (loss) income per common share- Basic .....	\$ (0.00)	\$ 0.01
Net (loss) income per common share- Diluted .....	\$ (0.00)	\$ 0.01
Weighted average common shares outstanding- Basic.....	28,993,752	28,993,752
Weighted average common shares outstanding- Diluted.....	28,993,752	29,044,002

See accompanying notes.

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

	Three Months Ended September 30,	
	2008 <u>(unaudited)</u>	2007 <u>(unaudited)</u>
Operating activities:		
Net (loss) income applicable to common shareholders.....	\$ (5,745)	\$ 191,065
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	35,976	17,549
Deferred taxes.....	(1,016)	125,503
Stock based compensation due to variable accounting.....	-	7,675
Stock based compensation.....	-	7,879
Changes in assets and liabilities:		
Accounts and notes receivable.....	86,139	12,951
Prepaid expenses, deposits and other.....	(93,893)	34,206
Accounts payable and accrued liabilities.....	2,877	(84,873)
Due to related party.....	(23,356)	(48,068)
Deferred revenue and other.....	<u>18,115</u>	<u>(21,385)</u>
Net cash provided by operating activities.....	22,369	242,502
Investing activities:		
Purchases of property and equipment.....	(49,963)	(64,562)
Purchase of company-operated stores.....	<u>(359,597)</u>	<u>(50,000)</u>
Net cash used in investing activities.....	(409,560)	(114,562)
Financing activities:		
Payment of preferred stock dividends.....	(582)	(582)
Payment of capital lease obligation and notes payable.....	<u>(22,132)</u>	<u>(8,385)</u>
Net cash used in financing activities.....	<u>(22,714)</u>	<u>(8,967)</u>
Net change in cash and cash equivalents.....	(409,905)	118,973
Cash and cash equivalents at beginning of year.....	<u>4,761,725</u>	<u>4,859,025</u>
Cash and cash equivalents at end of period.....	<u>\$ 4,351,820</u>	<u>\$ 4,977,998</u>
Cash paid for the period for:		
Interest.....	<u>\$ 868</u>	<u>\$ 1,176</u>
Income taxes.....	<u>\$ 885</u>	<u>\$ 10,535</u>
Supplemental schedule of non cash investing and finance activities:		
Company-operated stores acquired under notes payable and release of notes receivable.....	<u>\$ ---</u>	<u>\$ 90,521</u>

See accompanying notes.

**PRECISION AUTO CARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008**

	<u>Common Shares</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Accumulated Deficit</u>	<u>Total</u>
Balance at June 30, 2008 .....	28,993,752	\$ 289,938	\$67,816,821	\$(48,790,750)	\$ 19,316,009
Net loss .....	<u>—</u>	<u>—</u>	<u>—</u>	<u>(5,745)</u>	<u>(5,745)</u>
Balance at September 30, 2008..	<u>28,993,752</u>	<u>\$ 289,938</u>	<u>\$67,816,821</u>	<u>\$(48,796,495)</u>	<u>\$ 19,310,264</u>

See accompanying notes.

#### 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 posted by the Company at [www.PinkSheets.com](http://www.PinkSheets.com), Filings.

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 – Accounting Policy

##### *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 expert to assist in estimating the fair value of franchising operations utilizing a discounted future 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 we use to manage the underlying business. Impairment testing is performed in the first quarter of each fiscal year. Based upon the current year analysis, management concluded that the \$9.3 million carrying value of goodwill was not impaired. There was additional goodwill of approximately \$129,000 associated with the purchase of the two centers during the first quarter that was not included in the annual impairment testing (see Note 6). 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 three months September 30, 2008 and 2007, respectively, reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company's Consolidated Financial Statements for the prior periods have not been restated to reflect, and do not include the impact of SFAS 123(R). As a result of the adoption of SFAS 123(R), the Company recognized a pre-tax charge of approximately \$0 and \$7,000 (included in general and administrative expenses), \$0 and \$5,000 after-tax and no impact per share on a diluted basis in the quarters ended September 30, 2008 and 2007, respectively, associated with the expensing of stock options. There were no non-vested shares as of September 30, 2008. Employee stock option compensation expense includes the estimated fair value of options granted, amortized on a straight-line basis over the requisite service period for the entire portion of the award.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Consolidated Statement of Operations. Prior to the adoption of SFAS 123(R), the Company accounted for the stock-based awards to employees and directors using the intrinsic value method. Additionally, certain outstanding stock options are subject to variable accounting. In the three months ended September 30, 2008, the Company did not record any compensation expense related to variable accounting for certain outstanding stock options. In the three months ended September 30, 2007, the Company recorded compensation expense of approximately \$7,000 related to variable accounting for certain outstanding stock options as a result of an increase in the Company's stock price over the related three month period.

A summary of option activity under all plans as of September 30, 2008, and changes during the period then ended is presented below:

	Shares <u>Under Option</u>	Weighted- Average Exercise <u>Price</u>	Weighted-Average Remaining <u>Contractual Term</u>
June 30, 2008.....	1,551,700	0.60	3.66
Options granted .....	-	-	
Options exercised .....	-	-	
Options forfeited.....	-	-	
September 30, 2008.....	1,551,700	0.60	3.41

No options were granted in the three months ended September 30, 2008 and 2007, respectively. The exercise price of options outstanding at September 30, 2008 ranged from \$0.25 to \$3.63 per share.

The intrinsic value of in the money options at September 30, 2008 and 2007 was approximately \$0 and \$20,000, respectively.

#### Note 3 – Earnings Per Share

The Company reports earnings per share ("EPS") in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share" which specifies the methods of computation, presentation, and disclosure. SFAS No. 128 requires the presentation of basic EPS and diluted EPS. Basic EPS is calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the period. Diluted EPS is calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the period plus the dilutive effect of common stock equivalents. The number of shares outstanding related to stock options and warrants at September 30, 2008 and 2007 was 1,895,320 and 1,945,320, respectively. Only stock options and warrants with exercise prices lower than the average market price of the common shares were included in the diluted EPS calculation. For the three months ended September 30, 2008 and 2007, respectively, 1,895,320 and 1,715,320 shares attributable to outstanding stock options and warrants were not included in the computation of diluted income per share as they were anti-dilutive.

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

	Three Months Ended	
	September 30, <u>2008</u>	September 30, <u>2007</u>
Numerator:		
Net (loss) income	\$ (5,163)	\$ 191,647
Preferred stock dividends	<u>(582)</u>	<u>(582)</u>
Net (loss) income applicable to common shareholders	\$ (5,745)	\$ 191,065
Denominator:		
Denominator for basic EPS weighted-average-shares .....	28,993,752	28,993,752
Common stock equivalents- stock options and warrants.....	<u>-</u>	<u>50,250</u>
Denominator for diluted EPS weighted-average-shares .....	28,993,752	29,044,002
Basic earnings per share applicable to common shareholders.....	\$ 0.00	\$ 0.01
Diluted earnings per share applicable to common shareholders.....	\$ 0.00	\$ 0.01

#### Note 4 – Contingencies

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

#### Note 5 – Area Developer Agreement

On August 20, 2008, the Company and the area developer for the Austin, Texas market mutually agreed to terminate the area developer agreement for the Austin, Texas market for an amount in excess of \$150,000. The Company bought back the area rights

and the amount was expensed as a direct franchise support cost during the three months ended September 30, 2008.

With no area developer for this market, the Company will support the franchisees and develop new stores in that market and will keep 100 percent of the royalty stream instead of splitting those monies with an area developer.

#### Note 6 – Acquisitions

On July 8, 2008, the Company purchased an existing center in Hayes, VA. This center will be operated as a company-owned store. The Company purchased the assets for \$175,000 with up to an additional \$85,000 available to the seller if certain sales objectives are met. Per the purchase agreement, an additional \$15,000 will be paid at the end of each quarter during the first fifteen months after the execution of agreement if the center reaches net sales of \$180,000 for the quarter. Additionally, if the store generates net sales in excess of \$120,000 during the first two months immediately following the initial fifteen month period, an additional amount up to \$10,000 will be paid. The goodwill is deductible for tax purposes. The following table summarizes the estimated fair values of the assets acquired at the date of acquisition:

Current assets	\$	8,000
Furniture & Fixtures		10,000
Equipment		53,000
Intangible asset		30,000
Goodwill		<u>74,000 - 159,000</u>
Total assets acquired	\$	<u>170,000 - 260,000</u>

On September 2, 2008, the Company purchased an existing Precision Tune Auto Care center in Hanover, PA. This center will also be operated as a company-owned store. The Company purchased the assets for \$80,000 with up to an additional \$8,000 available to the seller if certain sales objectives are met. Per the purchase agreement, an additional \$4,000 will be paid at the end of the first twelve months if the center exceeds net sales of \$285,000 for the year. If the store generates net sales in excess of \$300,000 during the first twelve months immediately following the purchase, an additional amount of \$8,000 will be paid. One payment in the amount of either \$4,000 or \$8,000 will be made depending on the results of the center. The goodwill is deductible for tax purposes. The following table summarizes the estimated fair values of the assets acquired at the date of acquisition:

Equipment	\$	40,000
Goodwill		<u>40,000 - 48,000</u>
Total assets acquired	\$	<u>80,000 - 88,000</u>

#### Note 7 - Recently Issued Accounting Standards

In December 2007, the FASB issued SFAS No. 141R, 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 research and development at fair value, and requires the expensing of acquisition-related costs as incurred. SFAS No. 141R is effective for us beginning July 1, 2009 and will apply prospectively to business combinations completed on or after that date.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB 51, which changes the accounting and reporting for minority interests. Minority interests will be recharacterized as noncontrolling interests and will be reported as a component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement and, upon a loss of control, the interest sold, as well as any interest retained, will be recorded at fair value with any gain or loss recognized in earnings. SFAS No. 160 is effective for us beginning July 1, 2009 and will apply prospectively, except for the presentation and disclosure requirements, which will apply retrospectively. We are currently assessing the potential impact that adoption of SFAS No. 160 may have on our financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities". SFAS No. 159 gives us the irrevocable option to carry many financial assets and liabilities at fair values, with changes in fair value recognized in earnings. SFAS No. 159 is effective for us beginning July 1, 2008, although early adoption is permitted. The adoption of SFAS 159 had no impact on the Company as the Company elected to not measure any of the assets or liabilities subject to this pronouncement at fair value.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. In February 2008, the FASB issued FASB Staff Position ("FSP") 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS No. 157 is effective for us beginning July 1, 2008; FSP 157-2 delays the effective date for certain items to July 1, 2009. The adoption of SFAS No. 157 had no impact on the consolidated financial statements.

#### **ITEM IV Management's discussion and analysis or plan of operation.**

##### **A) & B) Plan of Operation and Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussion and analysis or plan of operation of Precision Auto Care, Inc. (the "Company") should be read in conjunction with the unaudited interim consolidated financial statements and notes thereto included in "Item III. – Interim Financial Statements" of this quarterly report and the audited consolidated financial statements and notes thereto and the section titled "Item XVII - Management's Discussion and Analysis" in the Company's annual report for the fiscal year ended June 30, 2008 posted by the Company at [www.PinkSheets.com](http://www.PinkSheets.com), Filings on September 22, 2008. Historical results and percentage relationships set forth herein are not necessarily indicative of future operations.

The Company is a franchisor of automotive service centers located in the United States and in certain foreign countries. Through its franchised centers, services are provided to automobile owners and focus on those high-frequency items required on a periodic basis to maintain the vehicle properly.

#### **Critical Accounting Policies**

The following is a summary of the Company's critical accounting policies. These critical accounting policies require estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses reported in the consolidated financial statements. Due to their nature, estimates involve judgments based on available information. Actual results or amounts could differ from estimates and the difference could have a material impact on the consolidated financial statements. Therefore, understanding these policies is important in understanding the reported results of operations and the financial position of the Company.

##### *Revenue Recognition*

The Company enters into domestic Area Development agreements and international Master License agreements which grant the area developer and master licensor, respectively, the right to sell, on the Company's behalf, Precision Tune Auto Care franchises within a specific geographic region. Revenue from the sale of Area Development agreements and international Master License agreements is recognized as all material services or conditions related to the agreements are satisfied.

Revenue from the sale of a franchise is recognized when all material services and conditions have been satisfied, generally at the opening of the franchised center.

The Company's royalty revenue is recognized in the period earned and to the extent no known issues involving collection exist. In the case when revenues are not likely to be collected, the Company establishes reserves for such amounts. Such reserves are based upon our historical collection experience with the various franchisees taking into consideration the financial stability of such franchisees.

Product services in the form of equipment and other marketing materials related sales are recognized upon delivery to the franchisees.

Retail revenues are realized from providing maintenance and repair services, as well as from the parts that are provided as part of that service to the general public, are recognized when the service is performed.

##### *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 expert to assist in estimating the fair value of franchising operations utilizing a discounted future 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 we use to manage the underlying business. Impairment testing is performed in the first quarter of each fiscal year. Based upon the current year

analysis, management concluded that the \$9.3 million carrying value of goodwill was not impaired. There was additional goodwill of approximately \$129,000 associated with the purchase of the two centers during the first quarter that was not included in the annual impairment testing (see Note 6). However, there were no substantial changes in the operations of the automotive service centers that would indicate impairment.

### Income Taxes

The Company recognizes deferred income tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax liabilities and assets reflect the effects of tax losses and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company recognizes deferred tax assets if it is more likely than not that the asset will be realized in future years.

The Company regularly reviews the recoverability of its deferred tax assets and establishes a valuation allowance as deemed appropriate. In assessing the need for a valuation allowance against the deferred tax asset, management considers factors such as future reversals of existing taxable temporary differences, tax planning strategies and future taxable income exclusive of reversing temporary differences and carryforwards. As of June 30, 2007, the Company decided to release its remaining \$2.9 million valuation allowance as it has determined that it is more likely than not that the assets will be realized in future years.

While the Company anticipates recognizing a full provision in future periods, the Company expects to pay only alternative minimum tax and state taxes until such time that our net operating loss carryforwards are fully utilized.

### Results of Operations

#### Comparison of the three months ended September 30, 2008 to the three months ended September 30, 2007

Summary (in thousands)

	Three Months Ended September 30,			
	<u>2008</u>	<u>%</u>	<u>2007</u>	<u>%</u>
Automotive care franchising revenue .....	\$2,398	75	\$2,792	91
Company-operated store retail revenue .....	715	22	202	6
Other .....	<u>94</u>	<u>3</u>	<u>87</u>	<u>3</u>
Total revenues.....	<u>\$3,207</u>	100%	<u>\$3,081</u>	100%
Automotive care franchising direct cost .....	1,668	52	1,726	56
Company-operated store cost .....	710	22	236	8
Other .....	<u>87</u>	<u>3</u>	<u>79</u>	<u>2</u>
Total direct costs.....	<u>2,465</u>	77	<u>2,041</u>	66
General and administrative expense .....	736	23	746	24
Depreciation and amortization expense .....	36	1	17	1
Operating (loss) income.....	(30)	(1)	277	9
Other .....	27	1	51	1
(Loss) earnings before taxes .....	(3)	-	328	10
Provision for income taxes .....	<u>(2)</u>	-	<u>136</u>	<u>4</u>
Net (loss) income.....	<u>(5)</u>	-	<u>192</u>	<u>6</u>
Preferred stock dividends .....	1	-	1	-
Net (loss) income applicable to common shareholders .....	<u>\$ (6)</u>	<u>-%</u>	<u>\$ 191</u>	<u>6%</u>

*Revenue.* Total revenue for the three months ended September 30, 2008 was \$3.2 million, an increase of approximately \$126,000, or 4%, compared with total revenue of \$3.1 million for the three months ended September 30, 2007.

Automotive care franchising revenue for the three months ended September 30, 2008 was \$2.4 million, a decrease of approximately \$394,000, or 14%, compared with automotive care revenue of \$2.8 million for the three months ended September 30, 2007. The decrease in automotive care franchising revenue was due to a \$227,000 decrease in domestic royalty revenue. The decrease in royalties was driven by a decrease in operational centers which reduced system sales, which had decreased 6%. Additionally, for the three month period ending September 30, 2008, comparable domestic shop sales decreased approximately 3%. Also, there was a decrease in distribution and equipment sales of approximately \$124,000 and a decrease in international royalties of approximately \$72,000. These decreases were offset by an increase in franchise development of \$29,000.

Company-operated store retail revenue for the three months ended September 30, 2008 was \$715,000, an increase of approximately \$513,000, or 254%, compared to \$202,000 for the three months ended September 30, 2007. The increase in store retail revenue was primarily due to the Company operating seven automotive service centers during the three months ended September 30, 2008. The Company was operating two automotive centers during the three months ended September 30, 2007.

The Company recognized revenue from foreign franchisee operations of \$67,000 and \$110,000 for the three months ended September 30, 2008 and 2007, respectively.

Other revenue for the three months ended September 30, 2008 was \$94,000, an increase of approximately \$7,000, or 8%, compared to \$87,000 for the three months ended September 30, 2007. The increase in other revenue was primarily attributed to the additional revenue generated by the rebate programs.

*Direct Cost.* Total direct cost for the three months ended September 30, 2008 totaled \$2.5 million, an increase of \$424,000 or 21%, compared with \$2.0 million for the three months ended September 30, 2007.

Automotive care franchising direct cost for the three months ended September 30, 2008 totaled approximately \$1.6 million, a decrease of approximately \$58,000, compared with automotive care franchising direct cost of \$1.7 million for the three months ended September 30, 2007. For the three months ending September 30, 2008, there was a decrease of \$118,000 in expense for distribution and equipment which was a direct correlation with the decrease in revenue as well as the fact that there was one less employee in that business unit. Also, there was a decrease in area developer commission expense in the amount of approximately \$122,000 due to the fact the Company directly supports multiple markets (i.e., Dallas, TX and Florida) and keeps one hundred percent of the royalty stream instead of splitting the royalties with area developers. These decreases were offset by an increase in franchising direct cost due to the fact the Company repurchased and terminated the area developer agreement for the Austin, Texas market for an amount in excess of \$150,000 during the three months ended September 30, 2008 (see Item III – Note 5). There was no comparable expense for the three months ended September 30, 2007.

Company-operated store retail cost for the three months ended September 30, 2008 was \$710,000, an increase of approximately \$474,000, or 201%, compared to \$236,000 for the three months ended September 30, 2007. The increase in store retail cost was primarily due to the Company operating seven automotive service centers during the three months ended September 30, 2008. The Company was operating two automotive centers during the three months ended September 30, 2007. Additionally, the retail cost includes an internal cost allocation of approximately \$42,000 and \$12,000 for the years ended September 30, 2008 and 2007, respectively.

Other direct cost for the three months ended September 30, 2008 totaled \$87,000, an increase of \$8,000 or 10%, compared with \$79,000 for the three months ended September 30, 2007. The increase was attributed to the support costs associated with the rebate programs.

*General and Administrative Expense.* General and administrative expense was approximately \$736,000 for the three months ended September 30, 2008, a decrease of approximately \$10,000 or 1%, compared with approximately \$746,000 for the three months ended September 30, 2007. In the three months ended September 30, 2007, the Company recorded an expense of approximately \$7,000 related to variable accounting for certain outstanding stock options because the Company's stock price increased during the previous three months. Additionally, the Company recorded a pre-tax compensation expense of approximately \$7,000 due to the adoption of SFAS No. 123(R) (see Item III - Note 2). There were no comparable expenses for variable accounting or SFAS No. 123(R) for the three months ended September 30, 2008.

*Operating (Loss) Income.* The Company recorded operating loss for the three months ended September 30, 2008 of approximately \$30,000 compared with operating income of \$277,000 for the three months ended September 30, 2007. The decrease was mainly attributed to the expense incurred by the Company for repurchasing and terminating the area developer agreement for the Austin, Texas market. There was no comparable expense for the three months ended September 30, 2007.

*Other Income.* The Company recorded other income of \$27,000 for the three months ended September 30, 2008, which represents a decrease of approximately \$24,000 or 47% compared with \$51,000 for the three months ended September 30, 2007. The decrease was primarily due to a decrease in the interest rates on the certificates of deposit thus decreasing interest income.

*Income Taxes.* The Company's effective tax rate for the three months ended September 30, 2008 and 2007 was approximately 40% and 41%, respectively.

*Net (Loss) Income Applicable to Common Shareholders and Earnings Per Share.* The Company recorded Net Loss Applicable to Common Shareholders of approximately \$6,000, or \$0.00 per share, for the three months ended September 30, 2008 compared to the Net Income Applicable to Common Shareholders of \$191,000, or \$0.01 per share, for the three months ended September 30, 2007.

## Liquidity and Capital Resources

### Sources and Uses of Cash

Cash at September 30, 2008 was \$4.4 million. During the period, cash provided by operations was approximately \$22,000.

Cash used in investing activities for the three months ended September 30, 2008 was approximately \$410,000. Cash used in investing activities during the three months ended September 30, 2008 consisted of the purchase of property and equipment of \$50,000 for use in the Company's franchise operations and \$360,000 for the purchase of two company-operated stores.

Cash used in financing activities for the three months ended September 30, 2008 was \$23,000. Cash used in financing activities during the period consisted primarily of the payments of dividends, notes payable and a capital lease obligation.

Management believes that the Company's current cash balance, cash generated from operations, and the available \$250,000 credit line will be sufficient to meet the Company's working capital needs, capital expenditures, and contractual obligations for fiscal year 2009. At September 30, 2008, the entire line of credit was available.

### 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 centers.

#### C) Off-Balance Sheet Arrangements.

The Company does not have any material off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on our financial condition.

#### ITEM V Legal proceedings.

**any current, past, pending, or threatened legal proceedings or administrative actions either by or against the issuer that could have a material effect on the issuer's business, financial condition, or operations and any current, past, or pending trading suspensions by a securities regulator. State the names of the principal parties, the nature and current status of the matters, and the amounts involved.**

From time to time, the Company and its subsidiaries are subject to 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 cases involving defaults and terminations of franchises.

The Company is involved in litigation. The details of the litigation are as follows:

**Rukiya Eaddy v. Heather Enterprises, Inc. dba Precision Tune Auto Care, Mary McCracken, and Precision Tune auto Care Incorporated, dba Precision Franchising LLC**, State Court of Fulton County, State of Georgia, Civil Action File No. 2007-EV-003229E, filed: July 25, 2008

This case stems from an assault and battery between the plaintiff, Rukiya Eaddy (Eaddy) and the President of a Precision Tune Auto Care (PTAC) franchisee, Mary McCracken (McCracken). Precision Tune Auto Care, Inc. (PTAC) does not believe it is a properly named party to this suit.

On July 24, 2006 Eaddy noticed steam coming from the hood of her vehicle and called the PTAC franchised location owned and operated by McCracken (the "Center"). Eaddy alleges that one of the employees of the Center quoted a price to Eaddy that was less than the amount she was asked to pay when she came in to pick up her vehicle on July 25, 2006. Eaddy alleges that McCracken assaulted her when she questioned the cost of the repairs. Eaddy is seeking compensatory and punitive damages, as well as reimbursement for the cost of the above referenced action and reasonable attorneys' fees.

PTAC does not expect to incur any liability in this case due to the fact that neither PTAC nor its affiliates had any control over the premises or the employees of the Center. In addition, franchisee has a duty to indemnify PTAC and its affiliates including Precision Franchising LLC. The franchisee's insurance carrier has agreed to provide a defense; however, PTAC has retained separate counsel to represent it in this matter. The parties are conducting discovery at this time.

**Precision Franchising LLC v. A&A Auto, Inc. and Angelo Manerchia**, United States District Court, Eastern District of Virginia Alexandria Division, 1:08CV538 GBL/TRJ, Filed: May 27, 2008.

This case stems from a breach of contract dispute between Precision Franchising LLC (PFL) and the Defendant, Angelo Manerchia (Manerchia), President of A&A Auto, Inc. (A&A).

Manerchia agreed, upon termination of the Precision Tune Auto Care franchise agreement (the "Franchise Agreement") between A&A and PFL, to cease operating his franchised Precision Tune Auto Care center (the "Center") and to cease using PFL's trademarks and trade dress that are registered with the United States Patent and Trademark Office (the "Proprietary Marks"). Manerchia, however, opened a competing business in near proximity to the Center.

On May 27, 2008, PFL filed suit to enforce its rights. Manerchia was served on June 3, 2008 and an answer was due on June 23, 2008. Manerchia did not timely file an answer. On July 15, 2008, the Judge entered an agreed order that (1) Defendants are not in default and are granted leave to file late pleadings in response to the Complaint (2) Defendants must file their responsive pleadings no later than July 14, 2008 and (3) Defendants have not waived any objection to venue, personal jurisdiction or subject matter jurisdiction. PFL and Manerchia are currently negotiating a settlement.

**Vigneswaran Thambirajah and Mahendra Kumar and the Personal Insurance Company and Canadian Fine Motors Inv. and 1589145 Ontario Inc. doing business as Precision Tune Auto Care Scarborough and PT Auto Care Canada, Inc.**, Ontario Superior Court of Justice, CV-0701719-00 B1, Filed: April 21, 2008.

This case stems from a personal injury sustained by the Plaintiff, Vigneswaran Thambirajah (Thambirajah), when a wheel came off of the vehicle driven by defendant Mahendra Kumar (Kumar) and struck Thambirajah's vehicle causing property and personal injury.

On April 15, 2006, Thambirajah was operating his vehicle, a 2004 Nissan Maxima, on Highway #401 in Canada when the wheel of Kumar's vehicle came off and hit the roof of Thambirajah's vehicle. Thambirajah filed suit against Kumar alleging that Kumar negligently operated the vehicle causing the accident. Thambirajah is asking for \$500,000 in general damages and \$500,000 in special damages, as well as attorney and court fees, plus interest. Kumar filed suit against Canadian Fine Motors (CFM) alleging that CFM sold Kumar an unsafe car. CFM filed suit against PT Auto Care Canada, Inc. (PT Canada), and Precision Tune Auto Care Scarborough (PTAC Scarborough), a franchisee of PT Canada, alleging that if the car was not safe, it was because PTAC Scarborough was negligent when it inspected the car and that PTAC Scarborough failed to properly reinstall the wheels when removing them to perform the inspection.

PT Canada intends to defend the claims filed against it. At this time, there is no evidence that Kumar had his vehicle inspected at PTAC Scarborough, and, if he did, PT Canada and the franchisee, PTAC Scarborough, have an independent contractor relationship since PT Canada did not control the business operations of its franchisee. In August, 2008, PT Canada filed a response to CFM denying the allegations asserted against it. PT Canada does not expect to incur any liability in this case. The parties are conducting discovery at this time.

**Double Eagle Refinery Superfund Site, Oklahoma City, OK-Small Party Settlement Offer to Precision Auto Care, Inc.**, dated: March 3, 2008.

Union Pacific Railroad Company (Union Pacific) has identified Precision Auto Care, Inc. (PACI) as a potentially responsible party in connection with the Double Eagle Refinery Superfund Site (Double Eagle Site) in Oklahoma City, Oklahoma. On February 11, 2008, Union Pacific sent a letter to PACI identifying three Precision Tune Auto Care Centers that allegedly arranged for the transportation of hazardous substances to the Double Eagle Site and offering PACI the chance to settle any liability relating to the Double Eagle Site for a lump sum payment of \$32,500.

PACI sent a letter to Union Pacific dated March 3, 2008 explaining that PACI is not a responsible party at the Double Eagle Site. PACI did not generate the hazardous materials in question, did not have any control over the hazardous materials that were transported to the Double Eagle Site, and did not control or make arrangements for disposal of the hazardous materials in question. PACI does not expect to incur any liability in this matter.

**Lumnivision, S.A. de C.V. v. Praxis Afinaciones, S.A. de C.V.**, Third Civil Court, First Judicial District, Monterrey, Nuevo Laredo, Mexico, Filed: 2002.

Lumnivision filed suit against Praxis Afinaciones, an indirect wholly owned subsidiary of the Company.

The amount in controversy is 766,000 Mexican Pesos, plus interest at the rate of 5% per month, for services under a contract.

The Company does not expect to incur liability in this case. Praxis Afinaciones denies the allegations.

**United Bank, NA v. C. Eugene Deal, Miracle Partners, Inc., Star Auto Center, Inc.**, Common Pleas Court of Cuyahoga County, Ohio, Case No. 01-CV0019, Filed: January 11, 2001.

Miracle Partners, Inc., a wholly-owned subsidiary of the Company, was party to a confessed judgment. Miracle Partners, Inc. is currently inactive and has no assets.

The amount in controversy is approximately \$1.3 million, the amount of the confessed judgment. The company's management believes this judgment will have no material impact on the company's consolidated results of operations. Furthermore, the Company believes that it has a meritorious claim against Mr. Deal for misrepresentations made in connection with PACI's acquisition of Miracle Partners, Inc. in 1997 for all amounts covered by the judgment.

**Letter from Crawley M. Kemp, II regarding the injury of Dalton Boyd at a Precision Tune Auto Care in Warner Robins, Georgia**

Crawley M. Kemp, II (Kemp) represents Dalton Boyd, a minor customer injured at a Precision Tune Auto Care franchise center (the "Center") located in Warner Robins, Georgia. Kemp has requested information regarding Precision Tune Auto Care Inc.'s insurance coverage and has claimed that Brittany Boyd, Dalton Boyd's mother, will make a claim against Precision Tune Auto Care, Inc. Precision Tune Auto Care, Inc. (PTAC) does not expect to incur any liability in this case due to franchisee's duty to indemnify PTAC and its affiliates, including Precision Franchising LLC.

The Company does not believe that any of the above proceedings 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.

**Item VI Defaults upon senior securities.**

NONE

**Item VII Other information.**

NONE

**Item VIII Exhibits.**

**A) Material Contracts.**

NOT APPLICABLE

**B) Articles of Incorporation and Bylaws.**

These have been posted by the Company at [www.PinkSheets.com](http://www.PinkSheets.com), Filings.

**Item IX            Certifications.**

**CHIEF EXECUTIVE OFFICER CERTIFICATION:**

I, Robert R. Falconi, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report of Precision Auto Care, Inc.,
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

IN WITNESS WHEREOF, the undersigned has executed this Certification as of this 7<sup>th</sup> of November, 2008.

Certified By:    /s/ Robert R. Falconi  
Robert R. Falconi  
Chief Executive Officer

**CHIEF FINANCIAL OFFICER CERTIFICATION:**

I, Mark P. Francis, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report of Precision Auto Care, Inc.,
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

IN WITNESS WHEREOF, the undersigned has executed this Certification as of this 7<sup>th</sup> of November, 2008.

Certified By:    /s/ Mark P. Francis  
Mark P. Francis  
Chief Financial Officer

[A signed original of this written certification will be retained by Precision Auto Care, Inc. and furnished to the Pink Sheets or its staff upon request.]