PROLONG INTERNATIONAL CORP
Form 10-Q
August 13, 2001

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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 June 30, 2001

OR

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

For the transition period from ____________________to______________________

Commission File No. 0-22803

PROLONG INTERNATIONAL CORPORATION
(Exact name of registrant as specified in its charter)

Nevada	6 Thomas Irvine, CA 92618	74-2
(State or other jurisdiction of incorporation or organization)	(Address of principal executive offices) (Zip Code)	(IRS Employe

(949) 587-2700
(Registrant's telephone number, including area code)

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.

(1) Yes [X] No [_]

(2) Yes [X] No [_]

There were 28,438,903 shares of the registrant's common stock ($0.001 par value) outstanding as of August 10, 2001.

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FORM 10-Q
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Item 1. Financial Statements

PROLONG INTERNATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS

ASSETS

	June 30, 2001 (Unaudited)	Dece
CURRENT ASSETS:		
Cash and cash equivalents	$ 114,268	$

Accounts receivable, net of allowance for doubtful accounts of $211,214 at June 30, 2001 and $168,775 at December 31, 2000, respectively	4,824,252	3
Inventories, net	858,804	
Prepaid expenses, net	157,376	
Income taxes receivable	12,000	
Prepaid television time	10,583	
Advances to employees, current portion	59,492	
Deferred tax asset	578,231	
Total current assets	6,615,006	5
Property and equipment, net	3,037,904	3
Intangible assets, net	6,276,644	6
Deferred tax asset, noncurrent	2,235,477	1
Investment in affiliate	120,539	
Other assets, net	117,227	
TOTAL ASSETS	$18,402,797	$17

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:		
Accounts payable	$ 2,482,499	$ 2
Accrued expenses	572,847	
Line of credit	2,804,381	2
Notes payable, current	727,087	
Total current liabilities	6,586,814	5
Notes payable, noncurrent	2,250,181	2
Total liabilities	8,836,995	8
COMMITMENTS AND CONTINGENCIES (Note 7 & 8)		
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.001 par value; 50,000,000 shares authorized; no shares issued or outstanding	---	
Common stock, $0.001 par value; 150,000,000 shares authorized; 28,438,903 shares issued and outstanding	28,439	
Additional paid-in capital	15,035,261	15
Accumulated deficit	(5,497,898)	(5
Total stockholders' equity	9,565,802	9
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$18,402,797	$17

See notes to consolidated condensed financial statements

PROLONG INTERNATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,	
	2001	2000
NET REVENUES	$ 3,929,116	$ 5,219,521
COST OF GOODS SOLD	1,164,630	1,367,184
GROSS PROFIT	2,764,486	3,852,337
OPERATING EXPENSES:		
Selling and marketing	1,759,720	3,178,945
General and administrative	914,033	1,266,933
Total operating expenses	2,673,753	4,445,878
OPERATING INCOME (LOSS)	90,733	(593,541)
OTHER INCOME (EXPENSE), net:		
Interest (expense)	(145,916)	(128,460)
Interest income	2,928	2,936
Total other (expense), net	(142,988)	(125,524)
INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES	(52,255)	(719,065)
PROVISION (BENEFIT) FOR INCOME TAXES	(32,685)	(207,985)
NET INCOME (LOSS)	$ (19,570)	$ (511,080)
NET INCOME (LOSS) PER SHARE		
Basic	($0.00)	($0.02)
Diluted	($0.00)	($0.02)
WEIGHTED AVERAGE COMMON SHARES		
Basic	28,438,903	28,445,835
Diluted options outstanding	0	0
Diluted	28,438,903	28,445,835

See notes to consolidated condensed financial statements

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PROLONG INTERNATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 24,990	$ 129
Adjustments to reconcile net income to net cash provided by (used) in operating activities:		
Depreciation and amortization	426,450	447
Provision for doubtful accounts	42,439	8
Deferred taxes	101,856	1,890
Reserve for inventory obsolescence	---	(108
Compensation costs related to options	---	46
Amortization of warrants issued to lender	84,186	
Loss on exchange of common stock for accounts receivable	---	(3
Changes in assets and liabilities:		
Accounts receivable	(1,620,799)	(1,345
Inventories	111,432	(38
Prepaid expenses	118,665	(467
Income taxes receivable	75,002	
Prepaid television time	(5,000)	(118
Other assets	100,182	22
Accounts payable	299,017	(468
Accrued expenses	(364,771)	292
Income taxes payable	---	145
Net cash (used in) provided by operating activities	(606,351)	430
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(12,153)	(3
Employee advances	(1,967)	17
Investment in affiliate	(120,539)	
Net cash (used in) provided by investing activities	(134,659)	13
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on notes payable	(25,304)	(22
Net proceeds (payments) on line of credit from bank	753,665	(1,117
Net cash provided by (used in) financing activities	728,361	(1,140
NET DECREASE IN CASH AND CASH EQUIVALENTS	(12,649)	(695
CASH AND CASH EQUIVALENTS, beginning of period	126,917	1,094

CASH AND CASH EQUIVALENTS, end of period	$ 114,268	$ 398
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Income taxes paid	$ 13,600	$ 92
Interest paid	$ 269,383	$ 282

SUPPLEMENTAL NONCASH INVESTING AND FINANCING ACTIVITIES
During 2000, the Company completed the following transactions:
Recorded $46,000 to additional paid-in capital for compensation costs related to stock options.
Recorded the exchange of 6,932 shares of common stock for relief of accounts receivable.

See notes to consolidated condensed financial statements.

PROLONG INTERNATIONAL CORPORATION
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

1. BUSINESS

Prolong International Corporation (PIC) is a Nevada corporation originally organized on August 24, 1981. In June 1995, PIC acquired 100% of the outstanding stock of Prolong Super Lubricants, Inc. (PSL), a Nevada corporation. In 1997, Prolong Foreign Sales Corporation was formed as a wholly-owned subsidiary of PIC. In 1998, Prolong International Holdings Ltd., was formed as a wholly-owned subsidiary of PIC. At the same time, Prolong International Ltd., was formed as a wholly-owned subsidiary of Prolong International Holdings Ltd. PIC, through its subsidiaries, is engaged in the manufacture, sale and worldwide distribution of a patented complete line of high-performance and high-quality lubricants and appearance products.

Management's Plans Regarding Financial Results and Liquidity - At June 30, 2001, the Company had an accumulated deficit of approximately $5,498,000. As a result, the Company is vigorously continuing to evaluate further reductions in operating expenses and manpower requirements, and revise vendor payment terms to the extent possible. We cannot guarantee that the timing of further reductions in operating expenses will be adequate to return to profitability for the remainder of the Year 2001 and beyond. There are also continued efforts to convert certain assets to cash on an accelerated basis which may include the sale and/or sale and leaseback of the current facility in Irvine, CA. Management will also continue to vigorously defend the litigation described in Note 7 of Notes to Consolidated Condensed Financial Statements. Management believes that these plans, if successfully executed, will provide adequate financial resources to sustain the Company's operations and enable the Company to continue as a going concern.

2. BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements include the accounts of PIC and its wholly-owned subsidiaries, PSL, Prolong Foreign Sales Corporation, Prolong International Holdings Ltd., and its wholly-owned subsidiary, Prolong International Ltd. (collectively, the Company or Prolong). All intercompany accounts have been eliminated in

consolidation. These financial statements have been prepared in accordance with generally accepted accounting principles 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 generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, including normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the three months and the six months ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ended December 31, 2001. For further information, refer to the Form 10-K for the year ended December 31, 2000 filed by the Company with the Securities and Exchange Commission.

3. INVENTORIES

Inventories consist of the following:

	June 30, 2001 (Unaudited)	December 31, 2000
Raw materials	$393,577	$330,641
Finished goods	465,227	639,595
	$858,804	$970,236

4. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	June 30, 2001 (Unaudited)	December 31, 2000
Building and improvements	$ 2,280,783	$2,280,783
Computer equipment	265,965	272,978
Office equipment	55,753	55,753
Furniture and fixtures	585,168	585,168
Automotive equipment	35,925	35,925
Exhibit equipment	115,143	115,143
Machinery and equipment	17,953	17,953
Molds and dies	233,117	213,951
	3,589,807	3,577,654
Less accumulated depreciation	(1,089,903)	(922,545)
	2,499,904	2,655,109
Land	538,000	538,000

	$ 3,037,904	$3,193,109
	===========	==========

5. LINE OF CREDIT

The Company has a $5,000,000 credit facility with a financial institution, expiring in May 2003. Such facility is collateralized by eligible accounts receivable and inventories. Interest is currently payable monthly at the rate of the financial institution's prime rate (6.75% at June 30, 2001), plus 4% subject to a minimum interest charge of $50,000 per quarter, and the credit facility contains certain defined net income and net equity financial covenants for the Year 2001. At June 30, 2001, the Company was in compliance with or had received a waiver which is dependent upon the Company and the financial institution executing an amendment to the credit agreement by August 15, 2001, for all financial covenants. As of June 30, 2001, $2,804,381 was outstanding and approximately $169,000 was available under the terms of the line of credit.

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NOTES PAYABLE

Notes payable consist of the following as of June 30, 2001:

a) Note payable to a bank bearing interest at 7.875% per annum to be repaid in monthly principal and interest payments of $13,050 with a final payment of all remaining unpaid principal and interest due on May 1, 2008.	$1,615,360
b) Loan from CDC Small Business Finance Corporation bearing interest at 7.65% per annum to be repaid in monthly principal and interest payments of $6,376 each through July 1, 2018.	686,908
c) Loan from ABQ Dolphin LP; interest is payable monthly at the rate of the Prime Rate (6.75% at June 30, 2001) plus 2.5%. The loan has a maturity date of October 30, 2001 and includes an option to extend for one additional year. In connection with this loan, the Company issued a warrant to purchase 900,000 shares of common stock at an exercise price of $0.1875. If the loan is paid in full on or before October 30, 2001, the Company may repurchase up to an aggregate of 300,000 of the shares subject to the warrant at a price of $0.05 per share.	675,000

	2,977,268
Less current maturities	(727,087)

	$2,250,181
	==========

Year ending December 31,

2001	$ 700,138
2002	53,974
2003	57,969
2004	61,909
2005	66,856
Thereafter	2,036,422
	$2,977,268

7. CONTINGENCIES

Litigation - Michael Walczak et al - On or about November 17, 1998, Michael Walczak et al (Walczak), on behalf of himself and other similarly situated shareholders of EPL filed a purported class action and derivative suit in the U.S. District Court (the Court) in San Diego, California against PIC, PSL, EPL and certain of their respective former and current officers and directors. The named plaintiffs allege breach of contract, certain fraud claims, civil RICO, breach of fiduciary duty and conversion and seek monetary damages. The named plaintiffs in the action are allegedly current EPL shareholders who hold less than two per cent (2%) of the outstanding shares of EPL's common stock, in the aggregate. The plaintiffs applied for a preliminary injunction to halt the sale of the assets of EPL to PIC and to prevent the dissolution of EPL.

On November 25, 1998, the Court granted a temporary restraining order without a hearing and before opposition could be submitted. On December 30, 1998, the Court held a hearing on whether a preliminary injunction should be issued in connection with such action. The Court entered a preliminary injunction based on the plaintiffs' (a) alleged claim for fraudulent conveyance in connection with PSL's license agreement with EPL and (b) alleged claim for breach of fiduciary duty. The preliminary injunction enjoins the further consummation of the asset purchase transaction and prevents EPL from completing its liquidation and dissolution until further notice from the Court. The preliminary injunction will last until the case is tried on its merits or until the preliminary injunction is otherwise dismissed. The Court ordered the Walczak plaintiffs to post a bond for $100,000, which bond was posted. PIC appealed the Court's preliminary injunction ruling, which appeal was subsequently denied.

The Prolong defendants successfully moved to change venue and the case was ordered transferred to the federal court in Orange County, California, where PIC's principal office is located. In December 1999, plaintiffs' counsel was disqualified from the matter on the grounds of unwaivable conflict of interest. Plaintiffs have selected new counsel, except for three of the plaintiffs who withdrew from the case. The Prolong defendants each filed and served motions to dismiss the complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. The motion has been granted in part and denied in part. There has been no ruling to date on the Walczak plaintiffs' request to certify the class as a class action. A mediation conference has been held and concluded and substantial settlement discussions have been undertaken. However, final resolution cannot presently be determined. PIC and PSL and their respective current officers and directors believe that the settlement, if approved, will not result in a material adverse affect on the Company's financial statements. If the settlement as proposed is not consummated, the Company will continue to vigorously defend against the claims.

Federal Trade Commission - On February 15, 1999, PSL entered into a negotiated Consent Order with the Federal Trade Commission (FTC) based upon concerns of the commission related to inadequate substantiation of certain advertising claims for Prolong Engine Treatment. Without admitting any of the allegations, the Company agreed that it would not make advertising claims without having adequate scientific substantiation for such claims. No fine or monetary redress was levied in connection with the FTC action.

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Four purported class action lawsuits based on the FTC action have been brought against PIC and/or PSL. Although meaningful settlement discussions are proceeding, final resolution of the below referenced FTC based lawsuits cannot presently be determined. The suits are identified as follows:

- Kachold et al v PSL was filed November 19, 1999 and is pending in the U.S. District Court, Northern District of Illinois, file No. 99-CV-08349. The case is a purported class action and individual action alleging violation of the Illinois Consumer Fraud Act, Magnuson Moss Consumer Products Warranty Act, and for damages. Prolong successfully filed a motion to dismiss the complaint, and plaintiff thereafter filed an amended complaint. PSL's officers and directors believe that there is no merit to the plaintiffs' complaint and are vigorously defending against the claims. The parties are presently involved in meaningful settlement discussions.

- Fernandes et al v PSL was filed January 5, 2000 in Los Angeles County Superior Court, file No. BC222712. The case is a purported class action alleging false advertising, unfair competition, violation of the California Consumer Legal Remedies Act, fraud, deceit, negligent misrepresentation and for equitable relief. PSL's officers and directors believe that there is no merit to the plaintiffs' complaint and are vigorously defending against the claims. The parties are presently involved in meaningful settlement discussions.

- Bowland et al v PSL was filed January 21, 2000 in County Court at Law No. 4, Nueces County, Texas, file No. 00-60119-4. The case is a purported class action alleging breach of contract, breach of express warranty and violations of the Texas Deceptive Trade Practices Act. PSL's officers and directors believe that there is no merit to the plaintiffs' complaint and are vigorously defending against the claims. The parties are presently involved in meaningful settlement discussions.

- Mata et al v PSL and PIC was filed February 18, 2000 in the District Court of Hidalgo County, Texas, 275th Judicial District, file No. C-292-00-E. The case is a purported class action alleging breach of contract and breach of express and implied warranty. A special appearance and motion to dismiss was filed by PIC and an answer and plea in abatement was filed by PSL in order to stay this matter based upon the prior filed Bowland case. PSL's officers and directors believe that there is no merit to the plaintiffs' complaint and are vigorously defending against the claims. The parties are presently involved in meaningful settlement discussions.

Helman et al v PSL and PIC et al - On April 8, 1997, prior to the filing of the Walczak complaint, the attorney who was disqualified from representing the plaintiffs in Walczak filed Helman et al v PSL and PIC et al in the Court of Common Pleas, Columbiana County, Ohio. The case was filed as a

purported class action alleging breach of fiduciary duty, breach of oral and written contract, and fraud, in 13 original causes of action. The court subsequently denied plaintiff's motion to certify the case as a class action. The appellate court in Ohio largely affirmed a series of orders by the trial judge in favor of PSL, the effect of which was to reduce the number of complaining parties from approximately one hundred, to seven. Trial of the remaining plaintiffs' matters is set for January 15, 2002. PSL's officers and directors believe that there is no merit to the plaintiffs' complaint and are vigorously defending against the claims.

PIC and its subsidiaries are subject to other legal proceedings, claims, and litigation arising in the ordinary course of business. PIC's management does not expect that the ultimate costs to resolve these matters will have a material adverse affect on PIC's consolidated financial position, results of operation or cash flows.

8. COMMITMENTS

The Company has outstanding noncancelable inventory purchase commitments with a contract packager of approximately $397,000 as of June 30, 2001. Under the terms of the agreement, the packager purchases components, manufactures, warehouses and distributes certain car care products for the Company. When inventories held by the packager exceed approximately 75 days from the date of production, the Company may be obligated to pay a storage handling fee of 1.5% per month, and/or purchase these inventories at the option of the packager.

9. INVESTMENT IN AFFILIATE

On March 31, 2001 the Company entered into an Organization Agreement with Prolong Environmental Energy Corporation (PEEC), a California Corporation, whereby the Company agrees to contribute up to $150,000 to PEEC as required to meet the operating working capital obligations for PEEC. The Company contribution shall be considered a capital contribution for PEEC in return for 5% of the issued and outstanding common stock of PEEC.

10. NEW ACCOUNTING PRONOUNCEMENT

In July 2001, the FASB issued SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and prohibits the use of pooling-of-interests method. SFAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. The amortization for goodwill from past business combinations will cease upon adoption of this Statement on December 30, 2001. Goodwill and intangible assets acquired in business combinations completed after June 30, 2001 must comply with the provisions of this Statement. Also under this Statement, companies will be required to evaluate all existing goodwill for impairment within six months of adoption by comparing the fair value of each reporting unit to its carrying value at the date of adoption. Any transitional impairment losses will be recognized in the first interim period in the year of adoption and will be recognized as the effect of a change in accounting principle.

The Company is evaluating the potential impact of adopting these pronouncements on the results of operations and financial position of the Company.

ITEM 2:

PROLONG INTERNATIONAL CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

	Percentage of Net Revenues			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Net revenues	100.0	100.0	100.0	100.0
Cost of goods sold	29.6	26.2	30.6	23.9
Gross profit	70.4	73.8	69.4	76.1
Selling and marketing expenses	44.8	60.9	41.2	50.0
General and administrative expenses	23.3	24.3	23.4	20.8
Operating income (loss)	2.3	(11.4)	4.8	5.3
Other income (expense)	(3.6)	(2.4)	(3.2)	(2.1)
Income (loss) before income taxes	(1.3)	(13.8)	1.6	3.2
Provision (benefit) for income taxes	(0.8)	(4.0)	1.3	2.2
Net income (loss)	(0.5)	(9.8)	0.3	1.0

Three Months Ended June 30, 2001 vs. Three Months Ended June 30, 2000

Net revenues for the three months ended June 30, 2001 were approximately $3,929,000 as compared to approximately $5,220,000 for the comparable period of the prior year, a decrease of $1,291,000 or 24.7%. Revenues for the three month period ended June 30, 2001 were derived from the following sources: Retail sales of $3,732,000; international and other sales of $100,000; direct response television sales of $33,000 and, industrial sales of $64,000. Revenues for the three month period ended June 30, 2000 were derived from the following sources: Retail sales of $4,176,000; international and other sales of $678,000; direct response television sales of $277,000, and industrial sales of $89,000.

During the second quarter of 2001, retail sales were 95.0% of total revenues while international and other sales comprised 2.5% of total revenues. During the second quarter of 2000, retail sales were 80.0% of total revenues while international and other sales comprised 13.0% of total revenues. The lower retail sales for the period ended June 30, 2001 versus the same period a year ago is attributable to a continuing soft market for specialty lubricants, competitive factors and also due to the decision to discontinue the direct response infomercial for lubricants in lieu of an ongoing evaluation of more cost effective means of promoting the line. International sales decreased due to a slower demand in South Africa and Asia.

Cost of goods sold for the three months ended June 30, 2001 was approximately $1,165,000 as compared to $1,367,000 for the comparable period of the prior year, a decrease of $202,000 or 14.8%. As a percentage of sales, cost of goods sold increased from 26.2% for the three months ended June 30, 2000 to 29.6% for the three months ended June 20, 2001. The increase was mainly attributable to a shift in product mix in the retail lubricants sales and the added cost of special promotional items.

Selling and marketing expenses of $1,760,000 for the three months ended June 30, 2001 represented a decrease of $1,419,000 over the comparable period of the prior year. This 44.7% decrease was primarily the result of decreased expenses for endorsement and sponsorship payments, promotional activities to promote product awareness, expenditures for television air-time purchases and salaries. Selling and marketing expenses as a percentage of sales were 44.8% for the three months ended June 30, 2001 versus 60.9% for the comparable period of the previous year.

General and administrative expenses for the three months ended June 30, 2001 were approximately $914,000 as compared to $1,267,000 for the three months ended June 30, 2000, a decrease of $353,000 or 27.9%. This decrease is primarily attributable to a decrease in legal expenses and salaries (headcount). The decrease in legal expenses was partially due to a $50,000 reduction in the accrual reserve for legal settlements. As a percentage of sales, general and administrative expenses decreased from 24.3% in 2000 to 23.3% in 2001.

Net interest expense of $146,000 for the three months ended June 30, 2001 represented an increase of $17,000 over the comparable period in 2000. The increase is attributable to the additional interest expense from the ABQ Dolphin LP note during the period.

Net loss for the three month period ended June 30, 2001 was approximately $(20,000) as compared to a net loss of approximately $(511,000) for the comparable period in the prior year, a decrease of $491,000. The decrease is a result of the factors discussed above.

Six Months Ended June 30, 2001 vs. Six Months Ended June 30, 2000

Net revenues for the six months ended June 30, 2001 were approximately $8,081,000 as compared to approximately $12,977,000 for the comparable period in the prior year, a decrease of $4,896,000 or 37.7%. Revenues for the six month period ended June 30, 2001 were derived from the following sources: Retail sales of $7,102,000; international and other sales of $733,000; direct response television sales of $101,000 and, industrial sales of $145,000. Revenues for the six month period ended June 30, 2000 were derived from the following sources: Retail sales of $11,076,000; international and other sales of $1,294,000; direct response television sales of $445,000, and industrial sales of $162,000.

For the six-month period ended June 30, 2001, retail sales were 87.9% of total revenues while international and other sales comprised 9.1% of total revenues. During the six months of 2000, retail sales were 85.3% of total revenues while international and other sales comprised 10.0% of total revenues. The lower retail sales for the six month period ended June 30, 2001 versus the same period a year ago are attributable to a decrease in lubricant sales of approximately

$3,974,000. The lubricant sales decline is attributable to a continuing soft market for specialty lubricants, higher than expected store inventory levels at major retailers, competitive factors and also due to the decision to discontinue the direct response infomercial for lubricants in lieu of an ongoing evaluation of more cost effective means of promoting the line. International sales for the period decreased $561,000 due to a slower demand in Asia and South Africa.

Cost of goods sold for the six months ended June 30, 2001 was approximately $2,472,000 as compared to $3,094,000 for the comparable period of the prior year, a decrease of $622,000 or 20.1%. As a percentage of sales, cost of goods sold increased from 23.9% for the six months ended June 30, 2000 to 30.6% for the six months ended June 30, 2001. The increase was mainly attributable to the shift in product mix in the retail lubricants sales, the added cost of special promotional items and product component price increases.

Selling and marketing expenses of $3,330,000 for the six months ended June 30, 2001 represented a decrease of $3,161,000 over the comparable period of the prior year. This 48.7% decrease was primarily the result of decreased expenses for endorsement and sponsorship payments, promotional activities to promote product awareness, expenditures for television air-time purchases and salaries. Selling and marketing expenses as a percentage of sales were 41.2% for the six months ended June 30, 2001 versus 50.0% for the comparable period of the previous year.

General and administrative expenses for the six months ended June 30, 2001 were approximately $1,891,000 as compared to $2,695,000 for the six months ended June 30, 2000, a decrease of $804,000 or 29.8%. This decrease is primarily attributable to a decrease in legal expenses and salaries (headcount). The decrease in legal expenses was partially due to a $50,000 reduction in the accrual reserve for legal settlements. As a percentage of sales, general and administrative expenses increased from 20.8% in 2000 to 23.4% in 2001. Even though the aggregate expenses declined during the period, the ratio of expenses as a percentage of sales increased due to the more than expected decline in sales during the period.

Net interest expense of $269,000 for the six months ended June 30, 2001 represented a decrease of $14,000 over the comparable period in 2000. The decrease is attributable to lower average balances in the credit line for the current period versus last year.

Net income for the six month period ended June 30, 2001 was approximately $25,000 as compared to a net income of approximately $130,000 for the comparable period in the prior year, a decrease of $105,000. The decrease is a result of the factors discussed above.

LIQUIDITY AND CAPITAL RESOURCES

The Company utilizes funds generated from operations and borrowings from an existing credit facility to meet its working capital requirements. At June 30, 2001, the Company had a net working capital of $28,000 as compared to a negative net working capital of $101,000 at December 31, 2000 or an increase of $129,000. During the period ended June 30, 2001, the Company used $606,000 in operations, which was primarily from an increase in receivables and a decrease in accrued expenses which was partially offset by increases in accounts payable, income taxes receivable and decreases in inventory, prepaid expenses and deferred taxes. The Company has a $5,000,0000 credit facility with a financial institution, expiring in May 2003.

Such facility is collateralized by eligible accounts receivable and inventories.

Interest is currently payable monthly at the rate of the financial institution's prime rate (6.75% at June 30, 2001) plus 4% subject to a minimum interest charge of $50,000 per quarter. The credit facility contains certain defined net income and net equity covenants. At June 30, 2001, the Company was in compliance with or had received a waiver which is dependent upon the Company and the financial institution executing an amendment to the credit agreement by August 15, 2001, for all financial covenants. As of June 30, 2001, $2,804,381 was outstanding and approximately $169,000 was available under the terms of the line of credit.

On October 30, 2000, the Company entered into a loan agreement with a lender for $675,000 with proceeds of approximately $504,000, net of loan costs and other payables. The loan has a maturity date of October 30, 2001 and includes an option to extend for one additional year. The loan is collateralized by a Third Priority Trust Deed lien against the Company's real property in Irvine, CA. Interest is payable monthly at the rate of the Prime Rate (6.75% at June 30, 2001) plus 2.5%.

The Company is currently seeking additional new financing arrangements through subordinated debt and/or equity providers. We cannot guarantee that we will be able to obtain funds when we need them or on acceptable terms, if at all. Any inability to obtain funds when we need them would have a material adverse effect on our financial condition. At June 30, 2001, the Company had an accumulated deficit of approximately $5,498,000. As a result, the Company is vigorously continuing to evaluate further reductions in operating expenses and manpower requirements, and revise vendor payment terms to the extent possible. We cannot guarantee that the timing of further reductions in operating expenses will be adequate to return to profitability for the remainder of the Year 2001 and beyond. There are also continued efforts to convert certain assets to cash on an accelerated basis which may include the sale and/or sale and leaseback of the current facility in Irvine, CA. Management will also continue to vigorously defend the litigation described in Note 7 of Notes to Consolidated Condensed Financial Statements. Management believes that these plans, if successfully executed, will provide adequate financial resources to sustain the Company's operations and enable the Company to continue as a going concern.

ITEM 3:

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

PIC's financial instruments include cash and long-term debt. At June 30, 2001 and December 31, 2000, respectively the carrying values of PIC's financial instruments approximated their fair values based on current market prices and rates. It is PIC's policy not to enter into derivative financial instruments. PIC does not currently have any significant foreign currency exposure since it does not transact business in foreign currencies. Due to this, PIC did not have significant overall currency exposure at June 30, 2001 and December 31, 2000.

RISK FACTORS AND FORWARD LOOKING STATEMENTS

This report contains certain forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that involve risks and uncertainties. In addition, the Company may from time to time make oral forward looking statements. Actual results are uncertain and may be impacted by the

factors discussed in more detail in the Company's Annual Report on Form 10-K for the year ended December 31, 2000 filed with the Securities and Exchange Commission. In particular, certain risks and uncertainties that may impact the

accuracy of the forward looking statements with respect to revenues, expenses and operating results including without limitation, the risks set forth in the risk factors section of the Annual Report on Form 10-K for the year ended December 31, 2000, which risk factors are hereby incorporated into this report by this reference. As a result, the actual results may differ materially from those projected in the forward looking statements.

Because of these and other factors that may affect the Company's operating results, past financial performance should not be considered an indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

PROLONG INTERNATIONAL CORPORATION
PART II--OTHER INFORMATION

Item 1. Legal Proceedings

Reference is made to Note 7 of the notes to consolidated condensed financial statements.

Item 4. Submission of Matters to a Vote of Security Holders.

(a) The Annual Meeting of Stockholders was held on June 20, 2001.
(b) Set forth below is the name of each director elected at the meeting and the number of votes cast for their election, the number of votes against their election, the number of votes abstained and the number of non-votes:

Name	Class #	Number of Votes "For"	Number of Votes "Against"	Number of Votes "Abstain"	Number of "Non-Votes"
Elton Alderman	III	22,934,419	2,260,258		
Thomas C. Billstein	III	22,934,419	2,260,258		

Following the Annual Meeting, the Board of Directors consists of:

	Class
Elton Alderman	III
Thomas C. Billstein	III
Gregory W. Orlandella	II
Gerry L. Martin	II
Richard L. McDermott	I
William J. Howell	I

(c) Proposal Two to appoint Deloitte & Touche, LLP as the Company's independent auditors resulted in the following number of votes for, against, abstain, withheld and non-vote:

Number of Votes "For"	Number of Votes "Against"	Number of Votes "Abstain"	Number of Votes "Withheld"	Number of "Non-Votes"
23,218,657	1,879,420	96,600		

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K

During the second quarter of 2001 the following Form 8-K's were filed:

On May 11, 2001, PIC filed a Form 8-K to disclose the resignation of Mr. Bruce F. Barnes (Director).

On June 25, 2001, PIC filed a Form 8-K to disclose the resignation of Mr. William J. Howell (Director).

SIGNATURES

Pursuant to the requirements 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.

PROLONG INTERNATIONAL CORPORATION

Date: August 13, 2001

/s/ Nicholas Rosier

Nicholas Rosier
Chief Financial Officer
(Principal Financial Officer)