PROLONG INTERNATIONAL CORP
Form 10-Q
November 13, 2001

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 September 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
(State or other jurisdiction of	Irvine, CA 92618
incorporation or organization)	(Address of principal executive offices) (Zip Code)

(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 November 13, 2001.

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FORM 10-Q
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PROLONG INTERNATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS

ASSETS

	September 30, 2001 (Unaudited)	December 31 2000
CURRENT ASSETS:		
Cash and cash equivalents	$ 33,792	$ 126,91
Accounts receivable, net of allowance for doubtful accounts of $230,853 at September 30, 2001 and $168,775 at December 31, 2000, respectively	3,827,820	3,245,89
Inventories, net	734,371	970,23
Prepaid expenses, net	239,284	360,22
Income taxes receivable	12,000	87,00

Prepaid television time	--	5,58
Advances to employees, current portion	43,865	57,52
Deferred tax asset	347,662	943,17
	5,238,794	5,796,55
Total current assets		
Property and equipment, net	2,955,030	3,193,10
Intangible assets, net	6,149,973	6,529,98
Deferred tax asset, noncurrent	2,576,586	1,972,38
Investment in affiliate	150,000	-
Other assets, net	129,155	223,15
TOTAL ASSETS	$ 17,199,538	$ 17,715,20

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:		
Accounts payable	$ 2,553,364	$ 2,183,48
Accrued expenses	603,104	937,61
Line of credit	1,932,551	2,050,71
Notes payable, current	728,019	725,44
Total current liabilities	5,817,038	5,897,25
Notes payable, noncurrent	2,236,794	2,277,13
Total liabilities	8,053,832	8,174,38
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	28,43
Additional paid-in capital	15,035,261	15,035,26
Accumulated deficit	(5,917,994)	(5,522,88
Total stockholders' equity	9,145,706	9,540,81
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 17,199,538	$ 17,715,20

See notes to consolidated condensed financial statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	200
NET REVENUES	$ 2,858,222	$ 3,651,886	$ 10,939,283	$ 16,628
COST OF GOODS SOLD	929,751	1,046,648	3,401,632	4,140
GROSS PROFIT	1,928,471	2,605,238	7,537,651	12,487
OPERATING EXPENSES:				
Selling and marketing	1,397,081	2,224,341	4,726,728	8,715
General and administrative	908,713	979,547	2,799,902	3,674
Total operating expenses	2,305,794	3,203,888	7,526,630	12,390
OPERATING INCOME (LOSS)	(377,323)	(598,650)	11,021	97
OTHER INCOME (EXPENSE), net:				
Interest (expense)	(147,656)	(122,522)	(417,039)	(405
Interest income	(1,509)	3,512	7,976	8
Total other (expense), net	(149,165)	(119,010)	(409,063)	(396
LOSS BEFORE PROVISION FOR INCOME TAXES	(526,488)	(717,660)	(398,042)	(299
PROVISION (BENEFIT) FOR INCOME TAXES	(106,392)	(213,124)	(2,936)	75
NET LOSS	$ (420,096)	$ (504,536)	$ (395,106)	$ (374
NET LOSS PER SHARE				
Basic	($0.01)	($0.02)	($0.01)	($
Diluted	($0.01)	($0.02)	($0.01)	($
WEIGHTED AVERAGE COMMON SHARES				
Basic	28,438,903	28,438,903	28,438,903	28,443
Diluted options outstanding				
	0	0	0	

Diluted	28,438,903	28,438,903	28,438,903	28,443

See notes to consolidated condensed financial statements

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

	Nine Months Ended September 30,	
	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (395,106)	$ (374,796
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	635,995	669,510
Provision for doubtful accounts	62,078	(249,732
Deferred taxes	(8,684)	1,677,341
Reserve for inventory obsolescence	--	(101,712
Compensation costs related to options	--	61,000
Amortization of warrants issued to lender	126,279	--
Loss on exchange of common stock for accounts receivable	--	(3,466
Changes in assets and liabilities:		
Accounts receivable	(644,006)	(745,522
Inventories	235,865	630,750
Prepaid expenses	(5,336)	(534,364
Income taxes receivable	75,002	--
Prepaid television time	5,583	(63,843
Other assets	88,254	(10,553
Accounts payable	369,882	(222,905
Accrued expenses	(334,514)	(143,762
Income taxes payable	--	150,029
Net cash provided by operating activities	211,292	737,975
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(12,153)	(10,834
Employee advances	13,660	34,362
Investment in affiliate	(150,000)	--
Net cash (used in) provided by investing activities	(148,493)	23,528
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on notes payable	(37,759)	(34,135
Net payments on line of credit from bank	(118,165)	(1,500,956
Net cash used in financing activities	(155,924)	(1,535,091
NET DECREASE IN CASH AND CASH EQUIVALENTS	(93,125)	(773,588

CASH AND CASH EQUIVALENTS, beginning of period	126,917	1,094,779
CASH AND CASH EQUIVALENTS, end of period	$ 33,792	$ 321,191
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Income taxes paid	$ 13,600	$ 92,000
Interest paid	$ 417,039	$ 405,238

SUPPLEMENTAL NONCASH INVESTING AND FINANCING ACTIVITIES

During 2000, the Company completed the following transactions:
Recorded $61,000 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 September 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 September 30, 2001, the Company had a negative net working capital of $578,000 and an accumulated deficit of approximately $5,918,000. 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. The Company is also 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. 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 nine months ended September 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:

	September 30, 2001	December 31, 2000
	(Unaudited)	
Raw materials	$ 440,278	$ 330,641
Finished goods	294,093	639,595
	$ 734,371	$ 970,236

4. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	September 30, 2001	December 31, 2000
	(Unaudited)	
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	(1,172,777)	(922,545)

	2,417,030	2,655,109
Land	538,000	538,000
	$ 2,955,030	$ 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 (6.00% at September 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 September 30, 2001, the Company was not in compliance with certain financial covenants under the credit agreement. The Company is currently discussing remedies with the lender. As of September 30, 2001, $1,932,551 was outstanding and approximately $165,000 was available under the terms of the line of credit.

6. NOTES PAYABLE

Notes payable consist of the following as of September 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.	$ 1,60
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.	68
c)	Loan from ABQ Dolphin LP; interest is payable monthly at the rate of the Prime Rate (6.00% at September 30, 2001) plus 2.5%. On October 8, 2001 the loan maturity date was extended to November 3, 2002. 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.	67
		2,96
Less current maturities		72
		$ 2,23

The following are annual minimum principal payments due under notes payable.

Year ending December 31,

2001	$ 68
2002	5
2003	5
2004	6
2005	6
Thereafter	2,03
	$ 2,96

7. CONTINGENCIES

Legal Proceedings - On November 17, 1998, Dr. Michael Walczak on behalf of himself and other shareholders of EPL Pro-Long, Inc., ("EPL") filed a purported class action and derivative suit in the U.S. District Court in San Diego, California against EPL, PIC, PSL and certain of their respective former and current officers and directors alleging breach of contract, certain fraud claims, civil RICO, breach of fiduciary duty and conversion and

sought monetary damages in connection with PIC's acquisition of the assets of EPL Prolong, Inc. On October 12, 2001 the case was settled as a class action, dismissing all of the claims with prejudice. In settlement, PIC will issue approximately 1,490,500 shares of "its" common stock to EPL, out of which one-third of these shares are to be distributed to certain of plaintiff's attorneys and two-thirds of these shares are to be distributed to EPL shareholders. This suit has been settled without any admission of wrongdoing or liability on the part of the defendants. Settlement of this suit will have no material adverse affect on the Company's financial position or results of operation.

In February 1999, PSL entered into a negotiated Consent Order with the FTC concerning the standards for adequate substantiation of engine treatment advertising claims, among others items. As a follow on to the FTC matter, four separate lawsuits were filed by individuals purporting to act as class representatives for consumers seeking redress based variously on allegations of false advertising, unfair competition, violation of various state consumer laws, fraud, deceit, negligent misrepresentation, breach of warranty and seeking equitable relief. Class counsel and the company have entered into a stipulation of settlement on three of the suits, namely Fernandes et al v PSL, Bowland et al v PSL and Mata et al v PSL, which settlement is being submitted to the court for preliminary approval. In the fourth and last of the FTC related suits, Kachold v PSL, a separate settlement was reached with the individual plaintiff for $1,000 and $1,000 in attorney fees, with the class claims being dismissed contingent upon court approval of the other class action settlements. The four FTC related lawsuits have been settled without any admission of wrongdoing or liability on the part of the Company. Settlement of these four suits will have no material adverse affect on the Company's financial position or results of operation.

On April 8, 1997, a lawsuit was filed by Francis Helman et al v EPL, PIC et al in the Court of Common Pleas, Columbiana County, Ohio as a purported class action alleging breach of fiduciary duty, breach of oral and written contract, and fraud, in thirteen original causes of action. The appellate court in Ohio largely affirmed a series of orders by the trial judge in favor of EPL, PIC et al, the effect of which was to reduce the number of complaining parties from approximately one hundred to less than twenty, and dismissing various causes of action. The court subsequently denied plaintiff's motion to certify the case as a class action. The remaining Helman plaintiffs have appealed the trial court's order denying certification of the case as a class action. Management believes that there is no merit to the plaintiffs' complaint, is vigorously defending against the claims, and does not believe the outcome will have a material adverse affect on the Company's financial position or results of operations.

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 $242,000 as of September 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 agreed to contribute up to $150,000 to PEEC as required to meet the operating working capital obligations for PEEC. The Company contribution, which was fulfilled as of September 30, 2001, 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 September 30, 2001 and prohibits the use of the 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 31, 2001. Goodwill and intangible assets acquired in business combinations completed after September 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 September 30,		Nine Months E September 30
	2001	2000	2001
Net revenues	100.0	100.0	100.0
Cost of goods sold	32.5	28.7	31.1
Gross profit	67.5	71.3	68.9
Selling and marketing expenses	48.9	60.9	43.2
General and administrative expenses	31.8	26.8	25.6
Operating income (loss)	(13.2)	(16.4)	0.1
Other income (expense)	(5.2)	(3.2)	(3.7)
Loss before income taxes	(18.4)	(19.6)	(3.6)
Provision (benefit) for income taxes	(3.7)	(5.8)	---
Net loss	(14.7)	(13.8)	(3.6)

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

Net revenues for the three months ended September 30, 2001 were approximately $2,858,000 as compared to approximately $3,652,000 for the comparable period of the prior year, a decrease of $794,000 or 21.7%. Revenues for the three month period ended September 30, 2001 were derived from the following sources: Retail sales of $2,604,000; international and other sales of $176,000; direct response television sales of $25,000; and industrial sales of $53,000. Revenues for the three month period ended September 30, 2000 were derived from the following sources: Retail sales of $3,125,000; international and other sales of $379,000; direct response television sales of $84,000; and industrial sales of $64,000.

During the third quarter of 2001, retail sales were 91.1% of total revenues while international and other sales comprised 6.2% of total revenues. During the third quarter of 2000, retail sales were 85.6% of total revenues while international and other sales comprised 10.4% of total revenues. The lower retail sales for the period ended September 30, 2001 versus the same period a year ago is attributable to a continuing soft market for specialty lubricants, competitive factors, the effect from the September 11, 2001 tragedy, which resulted in a slower consumer demand for the products 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 September 30, 2001 was approximately $930,000 as compared to $1,047,000 for the comparable period of the prior year, a decrease of $117,000 or 11.2%. As a percentage of sales, cost of goods sold increased from 28.7% for the three months ended September 30, 2000 to 32.5% for the three months ended September 30, 2001. The increase was mainly attributable to a shift in product mix in the retail lubricants sales and the added cost of free new promotional products.

Selling and marketing expenses of $1,397,000 for the three months ended September 30, 2001 represented a decrease of $827,000 over the comparable period of the prior year. This 37.2% 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 48.9% for the three months ended September 30, 2001 versus 60.9% for the comparable period of the previous year.

General and administrative expenses for the three months ended September 30, 2001 were approximately $909,000 as compared to $980,000 for the three months ended September 30, 2000, a decrease of $71,000 or 7.2%. This decrease is primarily attributable to a decrease in legal expenses and salaries (headcount). As a percentage of sales, general and administrative expenses increased from 26.8% in 2000 to 31.8% 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 $149,000 for the three months ended September 30, 2001 represented an increase of $30,000 over the comparable period in 2000. The increase is attributable to the additional interest expense from the ABQ Dolphin LP note during the period and interest charges related to settlement of vendor balances outstanding.

Net loss for the three month period ended September 30, 2001 was approximately $(420,000) as compared to a net loss of approximately $(505,000) for the comparable period in the prior year, a decrease of $85,000. The decrease is a result of the factors discussed above.

Nine Months Ended September 30, 2001 vs. Nine Months Ended September 30, 2000

Net revenues for the nine months ended September 30, 2001 were approximately $10,939,000 as compared to approximately $16,629,000 for the comparable period in the prior year, a decrease of $5,690,000 or 34.2%. Revenues for the nine month period ended September 30, 2001 were derived from the following sources: Retail sales of $9,707,000; international and other sales of $907,000; direct response television sales of $125,000 and, industrial sales of $200,000. Revenues for the nine month period ended September 30, 2000 were derived from the following sources: Retail sales of $14,206,000; international and other sales of $1,614,000; direct response television sales of $583,000, and industrial sales of $226,000.

For the nine-month period ended September 30, 2001, retail sales were 88.7% of total revenues while international and other sales comprised 8.3% of total revenues. During the nine months of 2000, retail sales were 85.4% of total revenues while international and other sales comprised 9.7% of total revenues. The lower retail sales for the nine month period ended September 30, 2001 versus the same period a year ago are mainly attributable to a decrease in lubricant sales of approximately $4,200,000. The lubricant sales decline is attributable to a continuing soft market for specialty lubricants, competitive factors, the effect from the September 11, 2001 tragedy, which resulted in a slower consumer demand for the products 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 and other sales for the period decreased $707,000 due to a slower demand in Asia and South Africa.

Cost of goods sold for the nine months ended September 30, 2001 was approximately $3,402,000 as compared to $4,141,000 for the comparable period of the prior year, a decrease of $739,000 or 17.8%. As a percentage of sales, cost of goods sold increased from 24.9% for the nine months ended September 30, 2000 to 31.1% for the nine months ended September 30, 2001. The increase was mainly attributable to the shift in product mix in the retail lubricants sales, the added cost of free new promotional products and product component price increases.

Selling and marketing expenses of $4,727,000 for the nine months ended September 30, 2001 represented a decrease of $3,989,000 over the comparable period of the prior year. This 45.8% 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 43.2% for the nine months ended September 30, 2001 versus 52.4% for the comparable period of the previous year.

General and administrative expenses for the nine months ended September 30, 2001 were approximately $2,800,000 as compared to $3,675,000 for the nine months ended September 30, 2000, a decrease of $875,000 or 23.8%. This decrease is primarily attributable to a decrease in legal expenses and salaries (headcount). The decrease in legal expenses was partially due to a $77,000 reduction in the accrual reserve for legal settlements. As a percentage of sales, general and administrative expenses increased from 22.1% in 2000 to 25.6% 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 $409,000 for the nine months ended September 30, 2001 represented an increase of $13,000 over the comparable period in 2000.

Net loss for the nine month period ended September 30, 2001 was approximately $(395,000) as compared to a net loss of approximately $(375,000) for the comparable period in the prior year, an increase of $(20,000). The increase 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 September 30, 2001, the Company had a negative net working capital of $578,000 as compared to a negative net working capital of

$101,000 at December 31, 2000 or an increase of $477,000. During the period ended September 30, 2001, the Company generated cash from operations of $211,0000, which was primarily from an increase in accounts payable, income taxes receivable and decreases in inventory and prepaid expenses which was partially offset by an increase in accounts receivable and a decrease in accrued expenses. 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 (6.00% at September 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 September 30, 2001, the Company was not in compliance with certain financial covenants under the credit agreement. The Company is currently discussing remedies with the lender. As of September 30, 2001, $1,932,551 was outstanding and approximately $165,000 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. On October 8, 2001, the loan maturity date was extended to November 3, 2002. 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 (6.00% at September 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 September 30, 2001, the Company had a negative net working capital of $578,000 and an accumulated deficit of approximately $5,918,000. 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 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 September 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 September 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 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K

During the third quarter of 2001 the following Form 8-K was filed:

On July 9, 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: November 13, 2001

/s/ Nicholas Rosier

Nicholas Rosier
Chief Financial Officer
(Principal Financial Officer)