ACR GROUP INC
Form 10-Q
January 14, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

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

For the quarterly period ended November 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 number 0-12490

ACR GROUP, INC.
(Exact name of registrant as specified in its charter)

Texas	74-2008473
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3200 Wilcrest Drive, Suite 440, Houston, Texas	77042-6039
Address of principal executive offices)	(Zip Code)

(713) 780-8532
(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, and (2) has been subject to such filing requirements for the past 90 days. Yes X No _____

Shares of Common Stock outstanding at December 31, 2001 - 10,681,294.

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PART I - FINANCIAL INFORMATION

Item 1. - Financial Statements

ACR GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	November 30, 2001 (Unaudited)	February 28, 2001
Current assets:		
Cash	$ 232,460	$ 171,249
Accounts receivable, net	18,501,649	15,975,668
Inventory	25,178,157	23,833,400
Prepaid expenses and other	297,171	642,912
Deferred income taxes	487,000	487,000
Total current assets	44,696,437	41,110,229
Property and equipment, net of accumulated depreciation	5,567,965	5,768,093
Deferred income taxes	773,000	973,000
Goodwill, net of accumulated amortization	6,049,565	6,222,895
Other assets	510,240	507,350
	$57,597,207	$54,581,567

LIABILITIES AND SHAREHOLDERS' EQUITY

	November 30, 2001	February 28, 2001
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	$ 895,685	$ 956,201
Note payable - revolving line of credit	19,864,108	-
Accounts payable	20,800,774	17,146,529
Accrued expenses and other liabilities	2,542,448	1,837,638
Total current liabilities	44,103,015	19,940,368
Long-term debt and capital lease obligations, less current maturities	2,243,375	24,494,007
Total liabilities	46,346,390	44,434,375
Shareholders' equity:		
Common stock	106,813	106,813
Additional paid-in capital	41,691,379	41,691,379
Accumulated deficit	(30,547,375)	(31,651,000)

Total shareholders' equity	11,250,817	10,147,192
	$ 57,597,207	$ 54,581,567

The accompanying notes are an integral part
of these condensed financial statements.

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ACR GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Nine months ended November 30,		Three months ended November 30,	
	2001	2000	2001	200
Sales	$123,225,812	$107,037,671	$ 37,007,419	$ 33,6
Cost of sales	96,722,828	84,118,449	29,026,243	26,4
Gross profit	26,502,984	22,919,222	7,981,176	7,1
Selling, general and administrative expenses	(23,764,347)	(21,003,156)	(7,974,733)	(7,3
Other operating income (expense)	(983)	47,305	66	
Operating income	2,737,654	1,963,371	6,509	(2
Interest expense	(1,646,264)	(1,810,323)	(463,701)	(6
Other non-operating income	359,172	303,393	128,675	1
Income before income taxes	1,450,562	456,441	(328,517)	(7
Provision for income taxes:				
Current	146,937	137,318	7,803	
Deferred	200,000	-	-	
Net income	$ 1,103,625	$ 319,123	$ (336,320)	$ (7
Weighted average shares outstanding:				
Basic	10,681,294	10,674,500	10,681,294	10,6
Diluted	10,692,047	11,216,436	10,681,294	10,6
Earnings per common share:				
Basic	$ .10	$ .03	$ (.03)	$
Diluted	.10	.03	(.03)	

The accompanying notes are an integral part
of these condensed financial statements.

ACR GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine months ended November 30,	
	2001	2000
Operating activities:		
Net income	$ 1,103,625	$ 319,123
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,067,714	936,129
Deferred income tax expense	200,000	-
Other	(20,000)	(3,856)
Changes in operating assets and liabilities:		
Accounts receivables	(2,533,620)	(2,522,517)
Inventory	(1,344,757)	(3,681,924)
Prepaid expenses and other assets	204,825	(415,093)
Accounts payable	3,719,568	4,859,904
Accrued expenses and other liabilities	704,612	533,606
Net cash provided by operating activities	3,101,967	25,372
Investing activities:		
Acquisition of property and equipment	(628,011)	(1,910,829)
Acquisition of business, net of cash acquired	-	(200,643)
Proceeds from disposition of assets	53,628	33,536
Net cash used in investing activities	(574,383)	(2,077,936)
Financing activities:		
Net borrowings on revolving credit facility	571,777	3,353,827
Payments on long-term debt	(3,038,150)	(1,289,776)
Net cash (used in) provided by financing activities	(2,466,373)	2,064,051
Net increase in cash	61,211	11,487
Cash at beginning of year	171,249	107,035
Cash at end of period	$ 232,460	$ 118,522

Schedule of non-cash investing and

financing activities:		
Acquisition of subsidiaries:		
Fair value of assets acquired	-	793,712
Fair value of liabilities assumed	-	817,915
Goodwill	-	404,203
Notes payable to sellers	-	152,000
Purchase of property and equipment under capital leases and notes (net of cash)	19,333	1,033,883

The accompanying notes are an integral part of these condensed financial statements.

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ACR GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1 - Basis of Presentation

The interim financial information included herein is unaudited; however, such information reflects all adjustments (consisting solely of normally recurring adjustments) which are, in the opinion of management, necessary for a fair statement of results for the interim periods. The results of operations for the three-month and nine-month periods ended November 30, 2001 is not necessarily indicative of the results to be expected for the full year.

Substantially all inventories represent finished goods held for sale.

2 - Contingent Liabilities

The Company has an arrangement with an HVACR equipment manufacturer and a field warehouse agent whereby HVACR equipment is held for sale in bonded warehouses located at the premises of the Company's operations in Georgia, Colorado and Tennessee, with payment due only when products are sold. Such inventory is accounted for as consigned merchandise and is not recorded on the Company's balance sheet. As of November 30, 2001, the cost of such inventory held in the bonded warehouses was $10,811,072.

The terms of the consignment agreement with the supplier further provide that the Company upon demand by the supplier must purchase merchandise not sold within a specified period of time. The Company believes that substantially all consigned merchandise will be sold in the ordinary course of business before any purchase obligation is incurred.

3 - Income Taxes

The current provision for income taxes consists principally of federal alternative minimum taxes and state income taxes. The provision for deferred taxes consists of a reduction of future deferred benefits expected to be realized as a result of the anticipated expiration of net operating loss carryforwards in fiscal 2003. The Company has net operating loss and tax credit carryforwards which offset substantially all of its federal taxable income.

4 - Debt

The Company has a revolving line of credit arrangement with a commercial bank ("Bank"). The maximum amount that may be borrowed under the revolving line of credit is $25 million, including up to $1 million for letters of credit. The maturity date of the credit facility is May 2003, with an automatic extension for one-year periods unless either party gives notice of termination to the other. At November 30, 2001, the Company had $19.9 million outstanding under the facility.

Because of lower than expected net income in the first three quarters of fiscal 2002, as of November 30, 2001, the Company was not in compliance with two financial covenants in its loan agreement with the Bank, and, to date, has not either obtained a waiver from the Bank or negotiated a revision to the covenant. Therefore, according to the strict provisions of the loan agreement, the Company's revolving line of credit is callable, and, as required by generally accepted accounting principles, such indebtedness is classified as a current liability in the balance sheet as of November 30, 2001. The Bank has

given no indication to date that it would intend to exercise any of its rights under the loan agreement in the event of default. Management has initiated discussions with the Bank concerning the financial covenants in the loan agreement and expects to reach an agreement before the end of fiscal 2002 to amend the relevant covenants and waive events of non-compliance. So long as the Company's ability to access its revolving credit facility remains unimpaired, management believes that cash flows from operations and the borrowing availability under the line of credit will provide sufficient liquidity to meet the Company's working capital requirements for existing operations, debt service and expected capital expenditures.

5 - Recently Issued Accounting Standards

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have definite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of fiscal 2003, beginning March 1, 2002. The impact of applying the provisions of the Statement has not yet been determined. The maximum possible increase to income before income taxes on an annual basis as a result of the nonamortization provision is approximately $300,000.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", and the accounting and reporting provisions of Accounting Principles Board Opinion ("APB") No. 30. This statement retains the fundamental provisions of SFAS No. 121 and the basic requirements of APB No. 30; however, it establishes a single accounting model to be used for long-lived assets to be disposed of by sale and it expands the presentation of discontinued

operations to include more disposal transactions. The provisions of this statement are effective for financial statements issued for fiscal years beginning after December 15, 2001. The Company does not anticipate that the statement will have a material impact on its financial position or results of operations.

6 - Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Nine Months Ended November 30,		Three
	2001	2000	200
Numerator:			
Net income	$ 1,103,625	$ 319,123	($33
Numerator for basic and diluted earnings per share - income available to common stockholders	$ 1,103,625	$ 319,123	($33
Denominator:			
Denominator for basic earnings per share - weighted average shares	10,681,294	10,674,500	10,68
Effect of dilutive securities:			
Employee stock options	-	21,680	
Warrants	10,753	520,256	
Dilutive potential common shares	10,753	541,936	
Denominator for diluted earnings per share - adj. weighted average shares and assumed conversions	10,692,047	11,216,436	10,68
Basic earnings per share	$ .10	$ .03	$
Dilutive earnings per share	$ .10	$ .03	$

ACR GROUP, INC. AND SUBSIDIARIES

Item 2. - Management's Discussion and Analysis of Financial Condition and Results of Operations

Comparison of Results of Operations for the Nine-Month and Three-Month Periods Ended November 30, 2001 and November 30, 2000

Nine Months Ended November 30, 2001 Compared to 2000

Net income increased to $1,103,625 in the nine-month period ended November 30, 2001 (fiscal 2002) from $319,123 in the nine-month period ended November 30, 2000 (fiscal 2001), an increase of 246%. Net income in fiscal 2002 includes a non-cash charge to deferred income taxes of $200,000. Excluding this charge, net income in fiscal 2002 would have increased 309% over the same period in fiscal 2001. The improvement in pre-tax income in fiscal 2002 was generally attributable to an increase in same-store sales and to a decline in operating losses at the ten branch operations opened during fiscal 2001 ("New Branches"). Such new branches typically incur costs prior to generating revenues for personnel and preparing for business operation, and subsequently for 12 to 18 months as sales ramp up to a breakeven volume. In the nine-month periods ended November 30, 2001 and 2000, aggregate operating losses for the New Branches were approximately $550,000 and $930,000, respectively.

Consolidated sales increased 15% in the nine-month period ended November 30, 2001, compared to the same period in 2000. Sales at the New Branches aggregated $12.0 million in the nine-month period ended November 30, 2001, compared to $2.0 million in the nine-month period ended November 30, 2000. Same-store sales for the 37 branches open more than one year at the beginning of the fiscal year (March 1) increased 8% in the nine-month period ended November 30, 2001, compared to a decrease of 1% in same-store sales in the same period of 2000. Same-store sales growth occurred at over 75% of the Company's branches, with the highest growth rates occurring in Florida and the western region of the United States. Sales of new lines of HVACR equipment, which were first introduced in fiscal 2001, contributed significantly to the sales increase at these operations.

The Company's gross margin percentage on sales was 21.5% for the nine-month periods ended November 30, 2001, compared to 21.4% in 2000. Lower than average gross margin percentages at the Company's new branch operations were offset by continued reductions in the net purchase cost of inventory through national buying arrangements. In addition, the gross margin percentage at the Company's sheet metal fabrication operation benefited by reductions in commodity steel prices while maintaining its sale prices of finished goods.

Selling, general and administrative ("SG&A") expenses increased 13% in the nine-month period ended November 30, 2001 compared to the same period of 2000, because of the costs associated with the New Branches. Expressed as a percentage of sales, SG&A expenses decreased from 19.6% in 2000 to 19.3% in 2001, as the Company gained operating leverage from same-store sales growth. Increases in both workers compensation costs and transportation costs attributable to fuel prices contributed to the overall increase in SG&A expenses.

Interest expense decreased 9% from 2000 to 2001, as lower interest rates on the Company's variable rate debt mitigated the cost of additional debt incurred to finance the New Branches in fiscal 2001. As a percentage of sales, interest expense decreased from 1.7% in 2000 to 1.3% in 2001. Other non-operating income, which consists primarily of finance charge collections,

increased 15% from 2000 to 2001.

The current provision for income taxes consists principally of federal alternative minimum taxes and state income taxes. The provision for deferred taxes consists of a reduction of future deferred benefits expected to be realized as a result of the anticipated expiration of net operating loss carryforwards in fiscal 2003. However, as a result of the Company's continued use of tax loss carryforwards, the Company will have minimal liability for Federal income taxes through fiscal 2003. See Liquidity and Capital Resources, below.

Three Months Ended November 30, 2001 Compared to 2000

Net loss declined to $336,320 in the quarter ended November 30, 2001 from $767,473 in the quarter ended November 30, 2000, a reduction of 56%. Such improvement in results of operations was attributable to the same factors as described above with respect to the nine-month period ended November 30, 2001. In the quarters ended November 30, 2001 and 2000, aggregate operating losses of the New Branches were approximately $305,000 and $580,000, respectively.

Sales increased 10% from the third quarter of fiscal 2001 to fiscal 2002, with same-store sales increasing 6%. Sales at the New Branches aggregated $3.5 million in the quarter ended November 30, 2001, compared to $1.4 million in the quarter ended November 30, 2000. A majority of the Company's branches generated increased sales, with the largest percentage growth occurring in the southeastern U.S. Sales in California remained stagnant for the second consecutive quarter and, in Colorado, sales slowed significantly because of a decline in residential new construction.

The Company's gross margin percentage on sales was 21.6% for the quarter ended November 30, 2001, compared to 21.3% in 2000. Such increase was generally attributable to an increase of 1.9% in the gross margin percentage at the New Branches compared to the same quarter of the preceding year.

SG&A expenses as a percentage of sales decreased from 22.0% in 2000 to 21.5% in 2001, because of the operating leverage associated with same-store sales growth. Interest expense decreased 30% from 2000 to 2001 principally as a result of lower average interest rates on the Company's variable rate debt.

Liquidity and Capital Resources

Current assets increased 9% from February 28, 2001 to November 30, 2001, compared to a 21% increase during the same period in 2000. Gross accounts receivable represented 49 days of gross sales as of November 30, 2001 compared to 50 days at November 30, 2000, reflecting a continuous focus on credit management and aggressive collection of delinquent accounts. Inventory from the end of February to the end of November increased by 6% in 2001, compared to an increase of 22% in 2000. The increases in current assets and inventory in 2000 were associated with the opening of the New Branches, and the increases in 2001 are a function of the increase in sales over the previous year.

The Company has credit facilities with a commercial bank ("Bank") which include a $25 million revolving line of credit, including up to $1 million for letters of credit, and a $1 million term loan facility for capital expenditures. At November 30, 2001, the Company had available credit of $1.6 million and $0.4 million under the revolving credit line and the capital expenditure term loan

facility, respectively. At November 30, 2001, the outstanding balance on the revolving credit line and the term loan facility bears interest at LIBOR plus 2.75% (currently 4.86%). Management believes that availability under the revolving credit facility will be adequate to finance the Company's working capital requirements of its existing operations for the

foreseeable future.

Because of lower than expected net income in the first three quarters of fiscal 2002, as of November 30, 2001, the Company was not in compliance with certain financial covenants in its loan agreement with the Bank, and, to date, has not either obtained a waiver from the Bank or negotiated revisions to the covenants. Therefore, according to the strict provisions of the loan agreement, the Company's revolving line of credit is callable, and, as required by generally accepted accounting principles, such indebtedness is classified as a current liability in the balance sheet as of November 30, 2001. The Bank has given no indication to date that it would intend to exercise any of its rights under the loan agreement in the event of default. Management has initiated discussions with the Bank concerning the financial covenants in the loan agreement and expects to reach an agreement before the end of fiscal 2002 to amend the relevant covenants and waive events of non-compliance. So long as the Company's ability to access its revolving credit facility remains unimpaired, management believes that cash flows from operations and the borrowing availability under the line of credit will provide sufficient liquidity to meet the Company's working capital requirements for existing operations, debt service and expected capital expenditures.

The Company has approximately $7 million in tax loss carryforwards which expire by fiscal 2003. Such operating loss carryforwards will substantially limit the Company's federal income tax liabilities in the near future.

Recently Issued Accounting Standards

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have definite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of fiscal 2003, beginning March 1, 2002. The impact of applying the provisions of the Statement has not yet been determined. The maximum possible increase to income before income taxes on an annual basis as a result of the nonamortization provision is approximately $250,000.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", and the accounting and reporting provisions of Accounting Principles Board Opinion ("APB") No. 30. This statement retains the fundamental provisions of SFAS No. 121 and the basic requirements of APB No. 30; however, it establishes a single accounting model to be used for long-lived assets to be disposed of by sale and it expands the presentation of discontinued operations to include more disposal transactions. The provisions of this

statement are effective for financial statements issued for fiscal years beginning after December 15, 2001. The Company does not anticipate that the statement will have a material impact on its financial position or results of operations.

Seasonality

The Company's sales volume and, accordingly, its operating income vary significantly during its fiscal year. The highest levels of sales occur during the times of the year when climatic conditions require the greatest use of air conditioning, since the Company's operations are concentrated in the warmer sections of the United States. Accordingly, sales will be highest in the Company's second quarter ending August 31, and will be lowest in its fourth quarter.

Inflation

The Company does not believe that inflation has had a material effect on its results of operations in recent years. Generally, manufacturer price increases attributable to inflation uniformly affect both the Company and its competitors, and such increases are passed through to customers as an increase in sales prices.

Safe Harbor Statement

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. Forward-looking statements involve risks and uncertainties that could cause actual results or outcomes to differ materially. The Company's expectations and beliefs are expressed in good faith and are believed by the Company to have a reasonable basis, but there can be no assurance that management's expectations, beliefs or projections will be achieved or accomplished. The forward-looking statements in this document are intended to be subject to the safe harbor protection provided under the securities laws. In addition to other factors and matters discussed elsewhere herein, the following are important matters that, in the view of the Company, could cause actual results to differ materially from those discussed in the forward-looking statements: the ability of the Company to continue to expand through acquisitions, the availability of debt or equity capital to fund the Company's expansion program, unusual weather conditions, the effects of competitive pricing and general economic factors.

Item 3. - Quantitative and Qualitative Disclosures About Market Risk

The Company is subject to market risk exposure related to changes in interest rates on a portion of its senior credit facility, which includes revolving credit and term notes. These instruments carry interest at a pre-agreed upon percentage point spread from either the prime interest rate or LIBOR. Under its senior credit facility the Company may, as its option, fix the interest rate for certain borrowings based on a spread over LIBOR for 30 days to

6 months. At November 30, 2001 the Company had $21.3 million outstanding under its senior credit facility, of which $11.3 million is subject to variable interest rates. The Company's objective in maintaining these variable rate borrowings is the flexibility obtained regarding lower overall costs as compared with fixed-rate borrowings.

PART II - OTHER INFORMATION

Item 6. - Exhibits and Reports on Form 8-K

(a) Reports on Form 8-K. None

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.

ACR GROUP, INC.

January 14, 2002	/s/ Anthony R. Maresca
Date	Anthony R. Maresca Senior Vice-President and Chief Financial Officer