ACR GROUP INC
Form 10-Q
July 16, 2001

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 May 31, 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 June 30, 2001 - 10,681,294.

PART I - FINANCIAL INFORMATION

Item 1. - Financial Statements

ACR GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	May 31, 2001 (Unaudited)	Februar 200
Current assets:		
Cash	$ 175,425	$ 171,2
Accounts receivable, net	20,694,337	15,975,6
Inventory	23,982,183	23,833,4
Prepaid expenses and other	301,674	642,9
Deferred income taxes	487,000	487,0
Total current assets	45,640,619	41,110,2
Property and equipment, net of accumulated depreciation	5,757,476	5,768,0
Deferred income taxes	973,000	973,0
Goodwill, net of accumulated amortization	6,166,044	6,222,8
Other assets	472,470	507,3
	$59,009,609	$54,581,5

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Current maturities of long-term debt and capital lease obligations	$ 993,608	$ 956,2
Accounts payable	20,688,306	17,146,5
Accrued expenses and other liabilities	1,981,952	1,837,6
Total current liabilities	23,663,866	19,940,3
Long-term debt and capital lease obligations, less current maturities	24,802,948	24,494,0
Total liabilities	48,466,814	44,434,3
Shareholders' equity:		
Common stock	106,813	106,8
Additional paid-in capital	41,691,379	41,691,3
Accumulated deficit	(31,255,397)	(31,651,0

Total shareholders' equity	10,542,795	10,147,1
	$59,009,609	$54,581,5

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

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

	Three months ended May 31,	
	2001	2000
Sales	$39,709,019	$33,178,4
Cost of sales	31,107,527	26,063,1
Gross profit	8,601,492	7,115,3
Selling, general and administrative expenses	(7,625,857)	(6,453,4
Other operating income (expense)	(1,048)	34,5
Operating income	974,587	696,4
Interest expense	(633,487)	(543,5
Other non-operating income	90,103	80,8
Income before income taxes	431,203	233,6
Provision for income taxes	35,600	33,3
Net income	$ 395,603	$ 200,3
Weighted average shares outstanding:		
Basic	10,681,294	10,670,6
Diluted	10,681,294	11,326,2
Earnings per common share:		
Basic	$ .04	$.
Diluted	.04	.

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

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

	Three m M
	2001
Operating activities:	
Net income	$ 395,603
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	353,722
Other	200
Changes in operating assets and liabilities:	
Accounts receivables	(4,689,867)
Inventory	(148,783)
Prepaid expenses and other assets	266,697
Accounts payable	3,606,710
Accrued expenses and other liabilities	144,314
Net cash used in operating activities	(71,404)
Investing activities:	
Acquisition of property and equipment	(270,768)
Acquisition of business, net of cash acquired	-
Proceeds from disposition of assets	-
Net cash used in investing activities	(270,768)
Financing activities:	
Net borrowings on revolving credit facility	639,081
Payments on long-term debt	(292,733)
Net cash provided by financing activities	346,348
Net increase in cash	4,176
Cash at beginning of year	171,249
Cash at end of period	$ 175,425

Schedule of non-cash investing and

financing activities:	
Acquisition of subsidiaries:	
Fair value of assets acquired	-
Fair value of liabilities assumed	-
Goodwill	-
Notes payable to sellers	-
Purchase of property and equipment under capital leases (net of cash)	-

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

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 period ended May 31, 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 May 31, 2001, the cost of such inventory held in the bonded warehouses was $13,666,154.

The terms of the consignment agreement with the supplier further provide that merchandise not sold within a specified period of time must be purchased by the Company. 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 provision for income taxes consists principally of federal alternative minimum taxes and state income taxes. 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. At May 31, 2001, the Company had $23.5 million outstanding under this credit facility and a maturity date set for May 2003, with an automatic extension for one-year periods unless either party gives notice of termination to the other.

5 - Earnings Per Share

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

	Three Months Ended May 31, 2001	Three Months Ended May 31, 2000
Numerator:		
Net income	$ 395,603	$ 200,335
Numerator for basic and diluted earnings per share - income available to common stockholders	$ 395,603	$ 200,335
Denominator:		
Denominator for basic earnings per share - weighted average shares	10,681,294	10,670,634
Effect of dilutive securities:		
Employee stock options	-	28,822
Warrants	-	626,819
Dilutive potential common shares	0	655,641
Denominator for diluted earnings per share - adj. weighted average shares and assumed conversions	10,681,294	11,326,275
Basic earnings per share	$ .04	$ .02
Dilutive earnings per share	$ .04	$ .02

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 Three-Month Periods Ended May 31, 2001 and May 31, 2000

Net income increased to $395,603 in the quarter ended May 31, 2001 (fiscal 2002) from $200,335 in the quarter ended May 31, 2000 (fiscal 2001), an increase of 97%. The improvement in results of operations in fiscal 2002 was generally attributable to an increase in same-store sales and to cost savings attributable to the closing of a branch operation in Memphis, TN in the fourth quarter of fiscal 2001.

Consolidated sales increased 20% during the quarter ended May 31, 2001 compared to the quarter ended May 31, 2000. Sales at the ten branch operations opened during fiscal 2001 aggregated $3.9 million in the quarter ended May 31, 2001. Same-store sales for the 37 branches open for more than one year at the beginning of the quarter increased 9% in the quarter ended May 31, 2001, compared to a decrease of 4% in the quarter ended May 31, 2000. Same-store sales growth was strongest 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. Sales increased only moderately at the Company's operations in Texas and Georgia compared to fiscal 2001, as a combination of mild temperatures and wet spring weather moderated demand for air conditioning products.

The Company's gross margin percentage on sales was 21.7% for the quarter ended May 31, 2001, compared to 21.4% for the quarter ended May 31, 2000. Lower than average gross margin percentages at the Company's new branch operations were more than 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 during the quarter ended May 31, 2001. The gross margin percentage in fiscal 2001 was adversely impacted by efforts at the Company's operations in Florida to sell the remaining inventory of a discontinued equipment product line.

Selling, general and administrative ("SG&A") expenses increased 18% in the quarter ended May 31, 2001 compared to the same quarter of 2000, because of the costs associated with the new branch operations. Expressed as a percentage of sales, SG&A expenses decreased in the first quarter from 19.5% in 2000 to 19.2% 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 increased 17% from 2000 to 2001 as a result of a 21% increase in borrowings from the previous year. The increase was partially mitigated by lower interest rates on the Company's variable rate debt. As a percentage of sales, interest expense decreased from 1.64% in 2000 to 1.60% in 2001.

The current provision for income taxes consists principally of federal alternative minimum taxes and state income taxes. As a result of the Company's substantial tax loss carryforwards, the Company has minimal liability for Federal income taxes. See Liquidity and Capital Resources, below.

Liquidity and Capital Resources

Current assets increased 11% from February 28, 2001 to May 31, 2001, substantially comprised of an increase in accounts receivable that resulted from the seasonal increase in sales. Gross accounts receivable represented 46 days of gross sales as of both May 31, 2001 and 2000, as the Company maintained its credit management standards and active collection efforts while seeking to develop sales at the branches opened in fiscal 2001. Management placed a heightened emphasis on controlling inventory levels after satisfying the stocking requirements of the new branches, and from the end of February to the end of May, inventory increased less than 1% in 2001, compared to 7% in 2000.

The Company has credit facilities with a commercial bank ("Bank") which include an $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. During the quarter ended May 31, 2001, the Company borrowed $429,353 against the capital expenditure facility and also borrowed $487,500, secured by a mortgage on its Katy, TX real estate and improvements. At May 31, 2001, the Company had available credit of $1.5 and $0.6 million under the revolving credit line and the capital expenditure term loan facility, respectively. At May 31, 2001, the outstanding balance on the revolving credit line and the term loan facility bears interest at LIBOR plus 2.75% (currently 6.81%). 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.

The Company has approximately $8 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.

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 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 May 31, 2001 the Company had $23.5 million outstanding under its senior credit facility. Based on this balance, an immediate change of one percent in the interest rate would cause a change in interest expense of approximately $235,000, or $.02 per basic share, on an annual basis.

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.

July 16, 2001	/s/ Anthony R. Maresca
Date	Anthony R. Maresca Senior Vice-President and Chief Financial Officer