ACR GROUP INC
Form 10-Q
January 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 November 30, 2000

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, 2000 - 10,681,294.

PART I - FINANCIAL INFORMATION

Item 1. - Financial Statements

ACR GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	November 30, 2000 (Unaudited)	February 29, 2000
Current assets:		
Cash	$ 118,522	$ 107,035
Accounts receivable, net	17,263,280	14,358,891
Inventory	22,489,594	18,445,097
Prepaid expenses and other	527,898	386,896
Deferred income taxes	487,000	487,000
Total current assets	40,886,294	33,784,919
Property and equipment, net of accumulated depreciation	5,893,525	3,689,448
Deferred income taxes	973,000	973,000
Goodwill, net of accumulated amortization	6,257,071	6,023,207
Other assets	484,479	370,929
	$54,494,369	$44,841,503

LIABILITIES AND SHAREHOLDERS' EQUITY

	November 30, 2000 (Unaudited)	February 29, 2000
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	$ 1,045,135	$ 1,788,255
Note payable - revolving line of credit	19,318,019	-
Accounts payable	17,838,845	12,182,803
Accrued expenses and other liabilities	2,290,440	1,741,710
Total current liabilities	40,492,439	15,712,768
Long-term debt and capital lease obligations, less current maturities	2,058,022	17,498,852
Total liabilities	42,550,461	33,211,620
Shareholders' equity:		
Common stock	106,813	106,706
Additional paid-in capital	41,691,379	41,696,584
Accumulated deficit	(29,854,284)	(30,173,407)

Total shareholders' equity	11,943,908	11,629,883
	$ 54,494,369	$ 44,841,503

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 end November 30,	
	2000	1999	2000	19
Sales	$107,037,671	$100,511,288	$ 33,649,949	$29,
Cost of sales	84,118,449	78,378,133	26,479,307	22,
Gross profit	22,919,222	22,133,155	7,170,642	6,
Selling, general and administrative expenses	(21,003,156)	(18,031,129)	(7,392,593)	(5,
Other operating income (expense)	47,305	(17,401)	4,184	
Operating income	1,963,371	4,084,625	(217,767)	
Interest expense	(1,810,323)	(1,482,460)	(659,206)	(
Other non-operating income	303,393	271,931	127,538	
Income (loss) before income taxes	456,441	2,874,096	(749,435)	
Provision for income taxes	137,318	226,500	18,038	
Net income	$ 319,123	$ 2,647,596	$ (767,473)	$
Weighted average shares outstanding:				
Basic	10,674,500	10,666,857	10,681,294	10,
Diluted	11,216,436	11,274,243	10,681,294	11,
Earnings per common share:				
Basic	$.03	$.25	$(.07)	
Diluted	.03	.23	(.07)	

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, 2000	Nine months ended November 30, 1999
Operating activities:		
Net income	$ 319,123	$ 2,647,596
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	936,129	864,042
Other	(3,856)	8,682
Changes in operating assets and liabilities:		
Accounts receivables	(2,522,517)	(682,021)
Inventory	(3,681,924)	(238,467)
Prepaid expenses and other assets	(415,093)	84,405
Accounts payable	4,859,904	(1,769,043)
Accrued expenses and other liabilities	533,606	498,838
Net cash provided by operating activities	25,372	1,414,032
Investing activities:		
Acquisition of property and equipment	(1,910,829)	(737,578)
Acquisition of business, net of cash acquired	(200,643)	-
Proceeds from disposition of assets	33,536	17,242
Net cash used in investing activities	(2,077,936)	(720,336)
Financing activities:		
Net borrowings on revolving credit facility	3,353,827	602,069
Payments on long-term debt	(1,289,776)	(1,269,379)
Net cash provided by (used in) financing activities	2,064,051	(667,310)
Net increase in cash	11,487	26,386
Cash at beginning of year	107,035	129,581
Cash at end of period	$ 118,522	$ 155,967

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)	1,033,883	196,966

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 and nine-month periods ended November 30, 2000 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, 2000, the cost of such inventory held in the bonded warehouses was $12,332,489.

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. 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, 2000, the Company had $20.2 million outstanding under this credit facility.

Because of lower than expected net income in the first three quarters of fiscal 2001, as of November 30, 2000, 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 a revision 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, 2000. Management is engaged in discussions with the Bank concerning the financial covenants in the loan agreement and expects such discussions toward a resolution of the situation to continue during the fourth quarter of fiscal 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. 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 branch operations, debt service and expected capital expenditures.

5. - Earnings Per Share

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

	Nine Months Ended November 30,	
	2000	1999
Numerator:		
Net income	$ 319,123	$ 2,647,596
Numerator for basic and diluted earnings per share - income available to common stockholders	$ 319,123	$ 2,647,596
Denominator:		
Denominator for basic earnings per share - weighted average shares	10,674,500	10,666,857
Effect of dilutive securities:		
Employee stock options	21,680	22,878

Warrants	520,256	584,508
Dilutive potential common shares	541,936	607,386
Denominator for diluted earnings per share - adj. weighted average shares and assumed conversions	11,216,436	11,274,243
Basic earnings per share	$ .03	$ .25
Dilutive earnings per share	$ .03	$ .23

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, 2000 and November 30, 1999

Nine Months Ended November 30, 2000 Compared to 1999

Net income decreased to $319,123 in the nine-month period ended November 30, 2000 (fiscal 2001) from $2,647,596 in the nine-month period ended November 30, 1999 (fiscal 2000), a decline of 88%. The change in results of operations in fiscal 2001 was attributable principally to both a decline in same store sales and gross profit and the costs associated with opening new branch operations. Since the end of the second quarter of fiscal 2000, the company has opened 12 branch operations. Such new branches typically incur costs prior to opening 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 period ended November 30, 2000, aggregate operating losses for the 12 branches referred to above were approximately $930,000.

Consolidated sales increased 6% in the nine-month period ended November 30, 2000, compared to the same period in 1999. Same store sales for branches open more than one year at the beginning of the fiscal year (March 1) decreased 1% in the nine-month period ended November 30, 2000, compared to an increase of 7% in same store sales in the same period of 1999. The decrease in same store sales in 2000 occurred across several geographic areas where the company operates, with only Florida and California attaining significant increases in same store sales. In particular, the company's operations in Colorado, New Mexico and Nevada, which have a relatively large concentration of sales to the new construction segment of the market, experienced a 4% decline in same store sales in 2000.

The Company's gross margin percentage on sales was 21.4% for the nine-month period ended November 30, 2000, compared to 22.0% in 1999, while the same store gross margin percentage decreased from 22.0% in 1999 to 21.8% in 2000. The company engages in continuous efforts to manage its gross margin percentage by

refining customer pricing strategies and negotiating national buying arrangements. The gross margin percentage at new branch operations is usually lower than at established branches because of competitive efforts to obtain initial customers.

Selling, general and administrative ("SG&A") expenses increased 16% in the nine-month period ended November 30, 2000 compared to the same period of 1999. Expressed as a percentage of sales, SG&A expenses increased from 17.9% in 1999 to 19.6% in 2000. Excluding the effect of branches opened or acquired after the end of the second quarter of fiscal 2000, SG&A expenses for the nine-month period ended November 30, 2000 were 18.9% of sales. The increase in SG&A expenses as a percentage of sales in fiscal 2001 is otherwise generally attributable to the combined effect of increases in overhead costs together with the decline in same store sales described above.

Interest expense increased 22% from 1999 to 2000 as a result of both higher interest rates on the Company's variable rate debt, and greater average outstanding borrowings under the Company's working capital line of credit. As a percentage of sales, interest expense has increased from 1.5% in 1999 to 1.7% in 2000. The additional borrowings were used to fund the initial costs and working capital requirements of new branch operations. Other non-operating income, which consists primarily of finance charge collections and the rental of a portion of the building owned in Gainesville, Florida, increased significantly from 1999 to 2000.

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.

Three Months Ended November 30, 2000 Compared to 1999

The Company incurred a net loss of $767,473 in the quarter ended November 30, 2000 compared to net income of $381,324 in the quarter ended November 30, 1999, a decline of 301%. Such decrease in results of operations was attributable to the same factors as described above with respect to the nine-month period ended November 30, 2000. In the quarter ended November 30, 2000, aggregate operating losses of the new branches were approximately $590,000.

Sales increased 15% from the third quarter of fiscal 2000 to fiscal 2001, with same store sales increasing 4% for branches open for more than one year at the beginning of the quarter. The quarterly sales increase was most pronounced in the Nevada, Florida and California market areas, with the company's operations in Florida and California each attaining double-digit increases in same store sales.

The Company's gross margin percentage on sales was 21.3% for the quarter ended November 30, 2000, down from 22.8% in 1999, with the effect of branches opened or acquired after the end of the second quarter of fiscal 2000 at 17.0% for the same period. To date, management has generally declined to reduce margins in 2000 in order to gain incremental sales unless the efforts are directed at new branch operations.

SG&A expenses as a percentage of sales increased from 19.9% in 1999 to 22.0% in 2000, generally because of the shortfall in planned sales during the quarter ended November 30, 2000. Excluding the effect of branches opened or acquired after the end of the second quarter of fiscal 2000, SG&A expenses for the three-month period ended November 30, 2000 were 20.4% of sales. Interest

expense increased 35% from 1999 to 2000 as a result of higher average interest rates on the Company's variable rate debt and an increase in borrowings under the Company's working capital line of credit.

Liquidity and Capital Resources

Current assets increased 21% from February 29, 2000 to November 30, 2000, compared to a 12% increase during the same period in 1999, principally because of the inventory stocked at the new branches. Gross accounts receivable represented 50 days of gross sales as of November 30, 2000 and 52 days at November 30, 1999, 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 22% in 2000, compared to an increase of 1% in 1999. The inventory increase through November 30, 2000 over the corresponding period in the prior year is located at the branches opened or acquired since the second quarter of fiscal 2000.

In May 2000, The Company amended its loan agreement with a commercial bank ("Bank") in order to expand its credit facilities. The new credit facilities include a $25 million revolving line of credit, a $1 million capital expenditure term loan facility, a $4 million term loan facility for the purchase of real estate and improvements, and an acquisition line of credit of up to $5 million. Borrowings under the revolving line of credit are limited to certain specified percentages of accounts receivable and inventory and, at November 30, 2000, the Company had available credit of $2.0 million under the revolver. At November 30, 2000, no funds were borrowed under either of the new term loan facilities or the acquisition line of credit. At November 30, 2000, the outstanding balance on both the revolving credit line and the term loan facilities bear interest at the prime rate plus 1/4% (presently 9.75%), adjusted monthly.

Because of lower than expected net income in the first three quarters of fiscal 2001, as of November 30, 2000, 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 a revision 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, 2000. Management has engaged in discussions with the Bank concerning the financial covenants in the loan agreement and expects such discussions toward a resolution of the situation to be finalized during the fourth quarter of fiscal 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. 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 and planned branch operations, debt service and expected capital expenditures.

The Company has approximately $29 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.

Year 2000 Issue

Prior to December 31, 1999, the Company undertook various measures to address its state of readiness to deal with the problem commonly known as the Year 2000 issue. Such measures included installing an upgrade to its existing integrated application software and, at one of the Company's subsidiaries that does not use the Company's integrated software, purchasing new computer hardware and migrating the subsidiary's computer programs to the new hardware. The costs incurred by the Company to achieve year 2000 compliance were less than $100,000 and were expensed as incurred.

Upon transitioning to Year 2000 in January 2000, the Company did not experience any related problems in its internal operations. To date, the Company has experienced no adverse effects as a result of suppliers, customers or service providers failing to adequately address the Year 2000 issue and further received assurances from its most significant suppliers that they were able to meet customer demands.

While management believes that it took adequate steps to address the Year 2000 issue, there can be no assurance that such problems may not arise in the future. Should Year 2000 issues ultimately have a material adverse impact on significant business partners or key parties that provide the country's business and public service infrastructure, the Company's operations could be similarly affected.

Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133, as amended by Statement of Financial Accounting Standard No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FAS Statement No. 133" ("SFAS 137") which is effective for fiscal years beginning after June 15, 2000, requires all derivatives to be recognized at fair value on the balance sheet. The Company plans to adopt SFAS 133 no later than February 28, 2001. The change is not expected to have a significant effect on the Company's financial statements.

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. In the third quarter of fiscal 2001, the Company entered into agreements to cap the LIBOR rate applicable to $8 million of its revolving credit facility for a period of up to three years. In addition, Company may, at its option, fix the interest rate for certain borrowings other than the revolving credit facility based on a spread over LIBOR for 30 days to 6 months. At November 30, 2000 the Company had $20.2 million outstanding under its senior credit facility. The Company's objective in maintaining substantial 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) Exhibits. Financial Data Schedule 27.1
(b) 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 16, 2001	/s/ Anthony R. Maresca
Date	Anthony R. Maresca Senior Vice-President and Chief Financial Officer

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