

ACR GROUP INC  
Form 10-K  
June 01, 2004  
Table of Contents

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# SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

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## FORM 10-K

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For Annual Reports Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the Fiscal Year Ended  
February 29, 2004

Commission File Number  
0-12490

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## ACR GROUP, INC.

(Exact name of registrant as specified in its Charter)

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Texas  
(State or other jurisdiction of  
incorporation or organization)

74-2008473  
(I.R.S. Employer  
Identification No.)

3200 Wilcrest Drive, Suite 440, Houston, Texas 77042

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (713) 780-8532

**Securities registered pursuant to Section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act:**

**Common Stock, par value \$.01 per share**

(Title of class)

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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. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark if the registrant is an accelerated filer (as defined in 12b-2 of the Securities Exchange Act of 1934) Yes  No

The aggregate market value of the voting stock (common stock) held by non-affiliates of the registrant as of August 29, 2003, the last business day of the registrant's most recently completed second quarter was \$4,717,327, based on the closing sale price on that date. For purposes of determining this number all executive officers and directors of the registrant as of August 31, 2003 are considered to be affiliates of the registrant. This number is provided only for purposes of the report on Form 10-K and does not represent an admission by either the registrant or any such person as to the status of such person.

The number of shares outstanding of the registrant's common stock as of April 30, 2004: 10,681,294 shares

#### **DOCUMENTS INCORPORATED BY REFERENCE**

The registrant's definitive Proxy Statement for its Annual Meeting of Shareholders to be held in August 2004 is incorporated by reference in answer to Part III of this report.

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**Table of Contents**

**TABLE OF CONTENTS**

	<b><u>Page</u></b>
<b><u>PART I</u></b>	
Item 1. <u>Business</u>	3
Item 2. <u>Properties</u>	6
Item 3. <u>Legal Proceedings</u>	6
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	6
<b><u>PART II</u></b>	
Item 5. <u>Market for Registrant's Common Equity and Related Stockholder Matters</u>	6
Item 6. <u>Selected Financial Data</u>	7
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	8
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	13
Item 8. <u>Financial Statements and Supplementary Data</u>	14
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	31
<b><u>PART III</u></b>	
Item 10. <u>Directors and Executive Officers of the Registrant</u>	31
Item 11. <u>Executive Compensation</u>	31
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management</u>	31
Item 13. <u>Certain Relationships and Related Transactions</u>	31
Item 14. <u>Controls and Procedures</u>	32
<b><u>PART IV</u></b>	
Item 15. <u>Exhibits, Financial Statement Schedules, and Reports on Form 8-K</u>	32

**Table of Contents**

**PART I**

**Item 1. Business.**

*General*

ACR Group, Inc. (which, together with its subsidiaries is herein referred to as the Company or ACRG) is a Texas corporation based in Houston. In 1990, the Company began to acquire and operate businesses engaged in the wholesale distribution of heating, ventilating, air conditioning and refrigeration (HVACR) equipment and supplies. The Company acquired its first operating company in 1990. Since 1990, ACRG has acquired or started seven additional HVACR distribution companies and now has 45 branch operations in nine states. The Company plans to continue expanding in the Sunbelt of the United States and in other geographic areas with a high rate of economic growth, through both acquisitions and internal growth.

*The HVACR Industry*

The Company sells supplies and equipment to installing contractors and dealers and to other technically trained customers responsible for the installation, repair and maintenance of HVACR systems. Maintenance of a large and diverse inventory base is an important element in the Company's sales.

The HVACR supply industry is segmented into discrete categories. First, it serves both commercial and residential HVACR businesses. Each of these segments is further divided into two markets—new construction sales and replacement and/or repair sales. Some companies choose to specialize in serving the new construction markets while others focus on the repair/replacement market, commonly referred to as the aftermarket. ACRG is not oriented toward any particular segment but instead concentrates on acquiring and developing profitable businesses in the Sunbelt region of the United States which have a significant market share within their segment of the HVACR distribution industry. The Company believes that its growth strategy is appropriate in view of the competitive nature of the HVACR industry and the continuing consolidation in that industry, discussed below.

There are many manufacturers of products used in the HVACR industry, and no single manufacturer dominates the market for a range of products. Some manufacturers limit the number and territory of wholesalers that may distribute their products, but exclusivity is rare. Many manufacturers will generally permit any distributor who satisfies customary commercial credit standards to sell their products. In addition, there are some manufacturers, primarily of equipment, that distribute their own products through factory branches. The widespread availability of HVACR products to distributors results in significant competition. There are an estimated three thousand HVACR wholesale distributors in the United States, and there is no single company or group of companies that dominates the HVACR distribution industry. The industry traditionally has been characterized by closely-held businesses with operations limited to local or regional geographic areas; however, a process of consolidation in this industry is ongoing, as many of these companies reach maturity and face strategic business issues such as ownership succession, changing markets and lack of capital to finance growth. Management's goal is to attract the present owners and management of such businesses by offering certain advantages related to economies of scale: lower cost of products from volume purchasing, new product lines, and financial, administrative and technical support.

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The Company believes that investing in the HVACR distribution industry has fewer economic risks than many other industries. Although the HVACR industry is affected by general economic conditions such as cycles in new home construction, sales of replacement equipment and repair parts for the existing base of installed air conditioning and heating systems provide a cushion against economic swings. The aftermarket is far less susceptible to changes in economic conditions than the new construction market and now represents approximately 70% of all units installed annually. This percentage should continue to increase as the base of installed systems expands. Much of the HVACR industry is also seasonal; sales of air conditioning and heating systems are generally largest during the times of the year when climatic conditions require the greatest use of such systems. Sales of refrigeration systems, which are generally to commercial customers, are subject to less seasonality.

## **Table of Contents**

The Company's operations are conducted through six business units that participate in the wholesale distribution of HVACR equipment and supplies:

### *ACR Supply*

The Company acquired ACR Supply (ACRS) in 1993, after making an initial investment in the company in 1991. At the end of fiscal 2004, ACRS had fourteen branches in Texas and one in Louisiana. Many of ACRS's branches have attained market share leadership in their respective areas. In major metropolitan areas such as San Antonio and Houston, ACRS encounters significantly more competition than in smaller cities. However, through aggressive sales efforts, the Houston branches have achieved a significant, but not dominant, share of their local HVACR markets.

ACRS sells primarily to licensed contractors serving the residential and light commercial (restaurants, strip shopping centers, etc.) markets. The company's sales mix is approximately 31% equipment and 69% parts and supplies, with the equipment and parts generally directed to the aftermarket and the supplies used principally in new construction.

### *Heating and Cooling Supply*

The Company acquired Heating and Cooling Supply (HCS) in 1990. HCS operates from one location in Las Vegas, Nevada. There are approximately 20 independent HVACR distributors in the Las Vegas area that compete with HCS. Management believes that HCS is among the top three of such distributors in terms of annual sales from branch operations in the local area.

Mirroring the rapid growth of the Las Vegas economy over the past decade, approximately 80% of HCS's sales are in the new construction market, and a majority of those sales are to the residential segment of the market. Unlike many HVACR distributors, HCS also has capabilities to service both the commercial plan and specifications market and the specialty products markets. The company is directing greater attention to the HVACR aftermarket in an effort to gain higher margin business and to diversify its customer base.

### *Total Supply*

Total Supply (TSI) has operated as an HVACR wholesale distributor in Georgia since 1992. Since 1993, TSI has distributed the Goodman brand of HVACR equipment in Georgia and now has the Goodman distribution rights to almost the entire state of Georgia. In 1999, TSI gained the distribution rights for Goodman equipment in the Nashville Tennessee trade area. TSI sells almost exclusively to the residential market, and management estimates that sales are approximately evenly split between new construction and the aftermarket. The company's sales mix is approximately 66% equipment and 34% parts and supplies. In addition to its branch in Nashville, TSI has four branches located in the Atlanta metropolitan area, one branch in Warner Robins, a suburb of Macon and another in Savannah, Georgia.

### *Florida Cooling Supply*

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In 1996, the Company organized Florida Cooling Supply, Inc. ( FCS ) and opened four branch operations in west central Florida, of which three remain open. The state of Florida is among the three largest in the United States in terms of installed HVACR systems. The Company's sales mix is approximately 40% equipment and 60% parts and supplies. In fiscal 2001, the Company opened branch operations in Gainesville and Jacksonville, Florida expanding its sales territory outside the Tampa Bay area of Florida. In fiscal 2004 the Company opened branches in Ft. Myers and Orlando and will open a branch in Sarasota in the second quarter of fiscal 2005. Management believes that Florida will continue to offer exceptional opportunities to open additional branch operations.

**Table of Contents**

*ACH Supply*

In 1997, the Company acquired the operating assets and liabilities of ACH Supply, Inc. ( ACH ). ACH had two branches located east of Los Angeles. From 1999 through 2003, ACH opened six additional branches including two in central California markets and four in southern California markets. ACH sells primarily HVACR parts and supplies, with equipment comprising approximately 30% of total sales. In addition to Florida, management believes that significant expansion opportunities remain in California.

*Contractors Heating & Supply ( CHS )*

In 1997, CHS acquired certain of the assets, and assumed certain of the liabilities, of Contractors Heating and Supply Company, an HVACR distributor based in Denver, with branch operations in Colorado Springs and Newcastle, Colorado, and in Albuquerque, New Mexico. CHS has operated in Denver since 1945, in Colorado Springs since 1959 and in Albuquerque since 1960, and is considered among the market leaders in each of its trade areas. CHS also operates a sheet metal shop in Colorado Springs, where products are fabricated for distribution through CHS 's wholesale operations. Approximately 15% of CHS 's total sales are products that it manufactures. In 1999, CHS opened a distribution branch in Fort Collins, Colorado, and, in 2000, acquired International Comfort Supply, Inc., a wholesale distributor based in El Paso, Texas. In fiscal 2001, the Company obtained the rights to distribute the Goodman line of equipment in all of its trade areas. In 2001 CHS opened a branch operation and distribution center in east Denver which was closed subsequent to fiscal year-end 2004.

***Executive Officers of the Registrant***

The Company 's executive officers are as follows:

<u>Name</u>	<u>Age</u>	<u>Position with the Company</u>
Alex Trevino, Jr.	67	Chairman of the Board and President
Anthony R. Maresca	53	Senior Vice President, Treasurer and Chief Financial Officer
A. Stephen Trevino	41	Senior Vice President, Secretary and General Counsel

Alex Trevino, Jr. has served as Chairman of the Board since 1988 and as President and Chief Executive Officer of the Company since July 1990.

Anthony R. Maresca has been employed by the Company since 1985. In November 1985 he was elected Senior Vice President, Chief Financial Officer and Treasurer. Mr. Maresca is a certified public accountant.

A. Stephen Trevino has been employed by the Company since March 1999, initially serving as General Counsel and directing various administrative functions. He was elected Senior Vice President and Secretary in August 2000.



*Employees*

As of February 29, 2004, the Company and its subsidiaries had approximately 422 full-time employees. Neither the Company nor its subsidiaries routinely use temporary labor. There are no Company employees represented by any collective bargaining units. Management considers the Company's relations with its employees to be good.

*Website Access to Company Reports*

The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports are available free of charge on the Company's website at [www.acrgroup.com](http://www.acrgroup.com) as soon as reasonably practical after such material is electronically filed with or furnished to the Securities and Exchange Commission.

Also, copies of the Company's annual report will be made available free of charge upon written request.

**Table of Contents**

**Item 2. Properties.**

The Company and its subsidiaries occupy office and warehouse space under operating leases with various terms. Generally, a branch location will contain 10,000 to 25,000 square feet of showroom and warehouse space. Branch locations that include a subsidiary's corporate office will be larger. The Company owns the facilities occupied by the Pasadena, Texas branch of ACRS, the Gainesville, Florida branch of FCS and a building and land leased to the company that purchased ACRG's filter manufacturing operations in 2004.

**Item 3. Legal Proceedings.**

As of February 29, 2004 the Company was not a party to any pending legal proceeding that is deemed to be material to the Company and its subsidiaries.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended February 29, 2004.

**PART II**

**Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters.**

The Company's common stock is traded on the over-the-counter market under the symbols ACRG, ACRG.OB or ACRG.BB, depending on the source of the quote.

The table below sets forth the high and low sales prices based upon actual transactions.

	<u>High</u>	<u>Low</u>
<i>Fiscal Year 2004:</i>		
1st quarter ended 5/31/03	\$ 0.58	\$ 0.32
2nd quarter ended 8/31/03	0.58	0.45
2nd quarter ended 11/30/03	0.97	0.46
4th quarter ended 2/29/04	1.49	0.85

*Fiscal Year 2003:*

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1st quarter ended 5/31/02	\$ 0.59	\$ 0.38
2nd quarter ended 8/31/02	0.52	0.36
2nd quarter ended 11/30/02	0.55	0.38
4th quarter ended 2/28/03	0.44	0.34

As of April 30, 2004, there were 463 holders of record of the Company's common stock. This number does not include the beneficial owners of shares held in the name of a broker or nominee.

The Company has never declared or paid cash dividends on its common stock. The Company's loan agreement with its senior lender expressly prohibits the payment of dividends by the Company. See Management's Discussion and Analysis of Financial Condition and Results of Operations-Liquidity and Capital Resources, and Note 3 of Notes to Consolidated Financial Statements.

**Table of Contents****Item 6. Selected Financial Data.**

The following selected financial data of the Company have been derived from the audited consolidated financial statements. This summary should be read in conjunction with the audited consolidated financial statements and related notes included in Item 8 of this Report. Since February 28, 2000, the increase in sales has resulted principally from internal expansion, as discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7. of this Report. The Company has never paid any dividends.

Certain reclassifications were made to the prior years' financial statements to conform with current year presentation.

The Company has not recorded a current provision for income taxes other than federal alternative minimum taxes and state income taxes for fiscal years 2000 through 2003 because of previously incurred net operating losses for which a tax benefit had not previously been recorded. In fiscal 2003, the Company recorded deferred federal income tax expense of \$251,000 to reduce the carrying value of the net deferred tax asset that related to the benefit realized from the utilization of its net operating loss carryforward. In fiscal 2004, the Company increased its federal tax rate to 34% to provide for current taxes due and to offset the current tax asset realized primarily from the operating loss carryforward. See Management Discussion and Analysis of Financial Condition and Results of Operations and Note 5 of Notes to Consolidated Financial Statements.

**Selected Financial Data**

(in thousands, except per share data)

	Year Ended February 28 or 29,				
	2004	2003	2002	2001	2000
<b>Income Statement Data:</b>					
Sales	\$ 174,353	\$ 161,822	\$ 155,490	\$ 136,433	\$ 126,468
Gross profit	38,558	35,673	33,570	29,452	28,135
Operating income	4,452	2,690	2,097	772	4,077
Income before income taxes	3,433	1,433	542	(1,341)	2,482
Provision for income taxes	(1,253)	(330)	(123)	(137)	(255)
Cumulative effect of accounting change		(483)			
Net income (loss)	\$ 2,180	\$ 620	\$ 419	\$ (1,478)	\$ 2,227
<b>Earnings per common share:</b>					
Basic:					
Before cumulative effect of accounting change	\$ .20	\$ .10	\$ .04	\$ (.14)	\$ .21
Cumulative effect of accounting change		(.04)			
	\$ .20	\$ .06	\$ .04	\$ (.14)	\$ .21

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Diluted:					
Before cumulative effect of accounting change	\$ .20	\$ .10	\$ .04	\$ (.14)	\$ .20
Cumulative effect of accounting change		(.04)			
	<u>\$ .20</u>	<u>\$ .06</u>	<u>\$ .04</u>	<u>\$ (.14)</u>	<u>\$ .20</u>

As of February 28 or 29,

	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Balance Sheet Data:					
Working capital	\$ 25,881	\$ 22,605	\$ 21,400	\$ 21,170	\$ 18,072
Total assets	58,727	52,728	56,630	54,582	44,842
Long-term obligations	22,950	22,075	23,728	24,494	17,499
Shareholders equity	13,366	11,186	10,566	10,147	11,630

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**Table of Contents****Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.*****Results of Operations***

Net income was \$2,180,000 (\$0.20 per share), \$620,000 (\$0.06 per share), \$419,000 (\$0.04 per share) in fiscal 2004, 2003 and 2002, respectively. An accounting change in fiscal 2003, and significant differences in the provisions for income taxes affect the comparability of net income among such years. Income before taxes and cumulative effect of accounting change was \$3,433,000, \$1,433,000, \$542,000 in fiscal 2004, 2003, and 2002, respectively.

The increase in income before taxes and cumulative effect of accounting change from fiscal 2003 to fiscal 2004 was principally attributable to improved operating results at several business units, particularly in Texas, California and Florida, the three states that utilize the most air-conditioning in the country. The business units in California and Florida are also the Company's newest business units and have grown rapidly. In fiscal 2004, for the first time, all of the Company's branch operations in both California and Florida generated operating income. Additionally, the Company sold the operating assets of two single-branch business units in fiscal 2004. The sales of the assets were at approximately net book value. Both business units had been recently unprofitable, generating aggregate operating losses of approximately \$280,000 and \$250,000 in fiscal 2002 and 2003, respectively, which declined to \$100,000 in fiscal 2004.

Effective March 1, 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and other Intangible Assets, which established new accounting and reporting requirements for goodwill and other intangible assets. Under SFAS No. 142, all goodwill amortization ceased effective March 1, 2002. Goodwill amortization for fiscal 2003 and 2004 would otherwise have been \$227,000 in each year. SFAS No. 142 requires that goodwill and other intangible assets deemed to have indefinite useful lives be reviewed annually for impairment. Utilizing the criteria set out in SFAS No. 142, the Company performed such impairment analysis as of March 1, 2002, and determined that it was appropriate to write off the unamortized amount of goodwill that was associated with its filter manufacturing operation. Net of taxes, the writeoff amounted to \$483,000, or \$0.04 per share, and in accordance with the new standard, was reported in the income statement for fiscal 2003 as the cumulative effect of a change in accounting principle. As of February 28, 2003 and 2004, the Company performed the required impairment tests and determined there were no further impairments of goodwill.

Same-store sales increased 9% in fiscal 2004, 4% in fiscal 2003 and 9% in fiscal 2002. By comparison, data compiled by a leading industry trade association indicate that industry-wide product shipments increased 1% in calendar 2003 and 7% in calendar 2002, and declined 6% in calendar 2001, from the preceding calendar years. Sales in fiscal 2004 at all business units other than in Georgia were equal to or greater than sales in fiscal 2003. Fiscal 2004 sales growth was particularly strong in California, propelled by the most favorable seasonal summer weather in several years. Sales growth was above average in Texas and Florida, also supported by seasonally warm weather in the summer of 2003. Conversely, sales declined in Georgia because unusually cool and wet weather conditions curbed the sales increase that customarily occurs during the summer. Fiscal 2004 sales stabilized in Colorado, where economic conditions beginning in the last half of fiscal 2002 had slowed residential new construction. In the second half of fiscal 2004, sales commenced pursuant to a new contract with a customer. Sales under this contract increased consolidated and same-store sales by 2 percentage points for fiscal 2004 compared to fiscal 2003. The contract is expected to continue through calendar 2004.

The Company's gross margin percentage was 22.1% in fiscal 2004, compared to 22.0% in fiscal 2003 and to 21.6% in fiscal 2002. The Company realizes a relatively low gross margin percentage on the large volume contract described in the preceding paragraph; sales under this contract decreased the gross margin percentage in fiscal 2004 by 0.3%. The increase in gross margin percentage each fiscal year is attributable both to continually improving pricing disciplines throughout the Company and to improved purchasing and payment terms from suppliers. In addition, margins at newer branch operations have increased consistently since their opening.



## **Table of Contents**

Selling, general and administrative ( SG&A ) costs as a percentage of sales were 19.6% in fiscal 2004, compared to 20.4% in fiscal 2003 and 20.2% in fiscal 2002. The decrease in SG&A costs as a percentage of sales in fiscal 2004 was attributable to the Company's ability to leverage fixed costs against increases in sales. The Company was not able to successfully accomplish such leverage in fiscal 2003, because of significant increases in insurance, fuel and rent costs.

Interest expense decreased 13%, 17% and 16% in fiscal 2004, 2003 and 2002 compared to the preceding fiscal years. The changes in interest expense in fiscal 2004 and 2003 resulted principally from a decrease in the average outstanding variable rate debt, and the decrease in interest expense in fiscal 2002 resulted from a series of interest rate cuts during 2001. In fiscal 2004, 2003 and 2002, interest expense was 0.9%, 1.1% and 1.3% of sales, respectively. Other non-operating income, which consists principally of finance charges to customers, increased 4% from fiscal 2003 to fiscal 2004, after declining 11% from fiscal 2002 to fiscal 2003. The increase in non-operating income in fiscal 2004 was a result of income generated from leasing real property to the buyer of the one of the business units sold. The decline in non-operating income in fiscal 2003 resulted from the Company's successful collection efforts that reduced the aggregate volume of delinquent customer accounts compared to the previous year.

Because of substantial tax loss carryforwards, the Company had minimal liability for Federal income taxes in fiscal 2002 and 2003. Current income tax expense in such years consisted principally of state income taxes. In fiscal 2003, the Company recorded deferred income tax expense of \$251,000 to reduce the carrying value of its net deferred tax asset that related to the benefit realized from the utilization of the tax loss carryforward. In fiscal 2004, the Company fully utilized its remaining tax loss carryforwards and was required to record current income tax expense for federal taxes in addition to state taxes.

### ***Critical Accounting Policies***

The accounting policies discussed below are critical to the Company's business operations and an understanding of the Company's financial statements. The financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make assumptions and estimates that affect the reported amounts of assets, liabilities, revenues and expenses in each reporting period. Management bases its estimates on historical experience and other factors that are believed to be reasonable under the circumstances. Actual results, once known, may vary from management's estimates.

### ***Revenue Recognition***

The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 104, Revenue Recognition ( SAB 104 ). Substantially all of the Company's revenues consist of sales of HVACR products that are purchased by the Company from suppliers; less than 5% of the Company's sales are of products that it manufactures. SAB 104 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the amounts recognized are fixed and determinable, and (4) collectibility is reasonably assured. The Company records revenue after it receives an order from a customer with a fixed determinable price and the order is either shipped or delivered to the customer.

### ***Vendor Rebates***



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The Company receives rebates from certain vendors based on the volume of product purchased from the vendor. The Company records rebates when they are earned, i.e. when specified purchase volume levels are reached. Vendor rebates attributable to unsold inventory are carried as a reduction of the carrying value of inventory until such inventory is sold, at which time the related rebates are used to reduce cost of sales.

## **Table of Contents**

### *Allowance for Doubtful Accounts*

The Company records an allowance for doubtful accounts for estimated losses resulting from the inability to collect accounts receivable from customers. The Company establishes the allowance based on historical experience, credit risk of specific customers and transactions, and other factors. Management believes that the lack of customer concentration is a significant factor that mitigates the Company's accounts receivable credit risk. Three customers represented 2.1%, 1.7% and 1.6% of consolidated fiscal 2004 sales, respectively, and no other customer comprised as much as 1% of sales. The number of customers and their distribution across the geographic areas served by the Company help to reduce the Company's credit exposure to a single customer or to economic events that affect a particular geographic region. Although the Company believes that its allowance for doubtful accounts is adequate, any future condition that would impair the ability of a broad section of the Company's customer base to make payments on a timely basis may require the Company to record additional allowances.

### *Inventory*

Inventories consist of HVACR equipment, parts and supplies and are valued at the lower of cost or market value using the average cost method. Substantially all inventories represent finished goods held for sale; raw materials represent less than 1% of inventories. When necessary, the carrying value of obsolete or excess inventory is reduced to estimated net realizable value. The process for evaluating the value of obsolete or excess inventory requires estimates by management concerning future sales levels and the quantities and prices at which such inventory can be sold in the ordinary course of business.

The Company holds a substantial amount of HVACR equipment inventory at several branches on consignment from a supplier. The terms of this arrangement provide that the inventory is held for sale in bonded warehouses at the branch premises, with payment due only when products are sold. The supplier retains legal title and substantial management control with respect to the consigned inventory. The Company is responsible for damage to and loss of inventory that may occur at its premises. The Company has the ability to return consigned inventory, at its sole discretion, to the supplier for a specified period of time after receipt of the inventory. The terms of the arrangement further provide that the supplier may require the Company to purchase consigned inventory not sold within a specified period of time. Historically, most consigned inventory is sold before the specified purchase date, and the supplier has never enforced its right to demand payment, instead permitting such inventory to remain on consignment.

This consignment arrangement allows the Company to have inventory available for sale to customers without incurring a payment obligation for the inventory prior to a sale. Because of the control retained by the supplier and the uncertain time when a payment obligation will be incurred, the Company does not record the consigned inventory as an asset upon receipt with a corresponding liability. Rather, the Company records a liability to the supplier only upon sale of the inventory to a customer. The amount of the consigned inventory is disclosed in the Company's financial statements as a contingent obligation.

### **Liquidity and Capital Resources**

After generating \$2.7 million cash flow from operations in fiscal 2003, the Company used \$0.2 million cash flow in operations in fiscal 2004, as accounts receivable and inventory increased as a result of greater sales and new branch operations. Accounts receivable represented 45 days of gross sales at the end of fiscal 2004 compared to 43 days at the end of fiscal 2003. Inventories increased \$2.8 million from February 28, 2003 to February 28, 2004, of which \$1.9 million is at branch operations opened in fiscal 2004.

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The Company made capital expenditures of \$0.5 million in fiscal 2004 compared to \$0.6 million in fiscal 2003. A majority of the assets acquired by the Company in both fiscal years were leasehold improvements at new and relocated branch operations and for warehouse equipment.

Net cash provided by financing activities was \$0.4 million in fiscal 2004, compared to using \$2.2 million in fiscal 2003. In fiscal 2004, the additional borrowings were used for working capital. In fiscal 2003, cash flow

**Table of Contents**

from operations was used to repay borrowings. The Company's cash management program provides that net cash flow is automatically directed to be applied to reduce the outstanding balance of the Company's revolving line of credit.

The Company's loan agreement ( Agreement ) with a commercial bank ( Bank ) provides a \$25 million revolving credit facility and additional credit facilities for the purchase of both real estate and capital assets. The Agreement terminates in May 2005, and is automatically extended for one-year periods unless either party gives notice of termination to the other. Restrictive covenants of the Agreement prohibit the Company from paying dividends, prepaying any subordinated indebtedness or incurring certain other debt without the Bank's consent, and also require the Company to maintain certain financial ratios. As of February 29, 2004, the Company was in compliance with all of the required financial ratios.

The interest rate on borrowings under the revolving credit facility is based on either the Bank's prime rate or LIBOR and varies depending on the Company's leverage ratio, as defined, determined quarterly. As of February 29, 2004, the applicable interest rate was the prime rate or LIBOR plus 2.75%, and the Company had elected the LIBOR option for substantially all amounts outstanding under the facility. The Company has fixed the interest rate on \$8 million of outstanding borrowings under the facility, and the balance of outstanding borrowings bears interest at a floating rate. At February 29, 2004, the average interest rate on all borrowings under the facility was 5.80%. Borrowings under the revolving credit facility are limited to 85% of eligible accounts receivable and 50% of eligible inventory amounts (which increases to 65% of eligible inventory amounts during certain specified months of the year). At February 29, 2004, the Company's available credit under the facility was approximately \$2.3 million.

The Agreement provides a capital expenditure term loan facility of \$1 million for capital assets. As of February 29, 2004, the Company had borrowed \$856,000 under the capital expenditure facility. Of such borrowings, \$419,000 was outstanding at February 29, 2004, and is repaid in equal monthly principal installments of \$14,266, plus interest. The Agreement also provides for financing the purchase of certain real estate and improvements. At February 29, 2004, the Company had indebtedness to the Bank for real estate loans of \$529,000, secured by a deed of trust on real estate either leased or used as a branch facility in the Houston area, which is repaid in equal monthly principal installments of \$6,463, plus interest. Both the real estate and the capital expenditures loan facilities bear interest at a variable rate, which were the prime rate or LIBOR plus 2.75% at February 29, 2004.

The Company has significant commitments for non-cancelable operating leases as of February 29, 2004. The majority of such commitments is for office and warehouse space occupied by the Company's branch operations. The Company also has operating leases for vehicles and office equipment. Management believes that its capital resources are better utilized for working capital needed to support the growth of operations than for investment in real property and other capital assets that may be leased.

The Company's future contractual obligations and potential commercial commitments as of February 29, 2004 are summarized as follows:

	<b>Payments Due by Period</b>				
		(in thousands)			
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
<b>Contractual Obligations</b>					
Revolving credit facility	\$ 21,086	\$	\$ 21,086	\$	\$
Long-term debt	1,752	283	489	216	764
Capital lease obligations	299	123	167	9	
Operating leases	18,521	5,195	7,420	3,800	2,107

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\$ 41,658	\$ 5,601	\$ 29,162	\$ 4,025	\$ 2,871
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**Other Commercial**

<b>Commitments</b>	<b>Amounts Committed</b>	<b>Expiration Per Period Less Than 1 Year</b>
Consigned inventory	\$ 5,466	\$ 5,466

## **Table of Contents**

The Company expects that cash flows from operations and the borrowing availability under its revolving credit facility will provide sufficient liquidity to meet its normal operating requirements, debt service and expected capital expenditures. The Company has engaged in negotiations to expand the capacity of its loan facilities and to extend the maturity dates, but has not yet decided whether to conclude such negotiations. Management believes that the Company will generate cash flow from operations in fiscal 2005, and has no plans that would require a significant investment of additional working capital. Subject to limitations set forth in its loan agreement with the Bank, funds available under the Company's revolving credit facility may also be utilized to finance acquisitions. However, management is not presently evaluating any acquisition opportunities.

### ***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 regions 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 fiscal 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.

### ***Recently Issued Accounting Standards***

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. The Interpretation requires certain guarantees to be recorded at fair value and also requires a guarantor to make certain disclosures regarding guarantees. The Interpretation's initial recognition and initial measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements became effective for the Company's first quarter of fiscal 2004. The adoption of the Statement had no material impact on the Company's financial position or results of operations.

In January 2003, the Emerging Issues Task Force (EITF) reached a final consensus on EITF Issue No. 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*. EITF 02-16 clarifies certain aspects for accounting and recording of consideration received from vendors. Certain provisions of the EITF are effective for fiscal years beginning after December 15, 2002, and other provisions of the EITF are effective for arrangements entered into after November 21, 2003. The Company's historical accounting for consideration received from vendors is consistent with the provisions of EITF 02-16. Therefore, the adoption of this standard has not had a material impact on the Company's financial statements.

In January 2003, the FASB issued Interpretation 46, *Consolidation of Variable Interest Entities*. In general, a variable interest entity is a corporation, partnership, trust, or other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. Interpretation 46 requires a

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variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The Interpretation is effective for all interest entities created after January 31, 2003 and is effective in the third quarter for any variable interest entities created before February 1, 2003. The adoption of the Interpretation did not have nor is expected to have a material impact on its financial statements.

**Table of Contents**

***Safe Harbor Statement***

This Annual Report on Form 10-K 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, which 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 factors 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 conditions.

**Item 7A. 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, at its option, fix the interest rate for certain borrowings based on a spread over LIBOR for 30 days to 6 months. At February 29, 2004 the Company had \$22.0 million outstanding under its senior credit facility, of which \$14.0 million is subject to variable interest rates. Based on this balance, an immediate change of one percent in the interest rate would cause a change in interest expense of approximately \$140,000, or \$.01 per basic share, on an annual basis.



**Table of Contents**

**Item 8. Financial Statements and Supplementary Data.**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS  
OF ACR GROUP, INC. AND SUBSIDIARIES**

	<b>Page</b>
<u>Report of Independent Auditors</u>	15
<u>Consolidated Balance Sheets as of February 29, 2004 and February 28, 2003</u>	16
<u>Consolidated Statements of Operations for the fiscal years ended February 29, 2004, February 28, 2003 and 2002</u>	18
<u>Consolidated Statements of Shareholders' Equity for the fiscal years ended February 29, 2004, February 28, 2003 and 2002</u>	19
<u>Consolidated Statements of Cash Flows for the fiscal years ended February 29, 2004, February 28, 2003 and 2002</u>	20
<u>Notes to Consolidated Financial Statements</u>	21

**Table of Contents**

**REPORT OF INDEPENDENT AUDITORS**

To the Board of Directors and Shareholders

ACR Group, Inc.

We have audited the accompanying consolidated balance sheets of ACR Group, Inc. and subsidiaries as of February 29, 2004 and February 28, 2003, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended February 29, 2004. Our audits also included the financial statement schedule listed in the index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of ACR Group, Inc. and subsidiaries at February 29, 2004 and February 28, 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended February 29, 2004, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, effective March 1, 2002, the Company changed its method of accounting for goodwill.

ERNST & YOUNG LLP

Houston, Texas

May 13, 2004

**Table of Contents****ACR GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(in thousands)****ASSETS**

	<b>February 29,</b>	<b>February 28,</b>
	<b>2004</b>	<b>2003</b>
	<u>          </u>	<u>          </u>
Current assets:		
Cash	\$ 52	\$ 104
Accounts receivable, net of allowance for doubtful accounts of \$793 in 2004 and \$685 in 2003	18,120	15,202
Inventory	27,833	24,997
Prepaid expenses and other	1,120	311
Deferred income taxes	1,167	1,458
	<u>          </u>	<u>          </u>
Total current assets	48,292	42,072
	<u>          </u>	<u>          </u>
Property and equipment, net of accumulated depreciation	4,461	4,955
Goodwill, net of accumulated amortization of \$1,038 in 2004 and 2003	5,258	5,258
Other assets	716	443
	<u>          </u>	<u>          </u>
Total assets	\$ 58,727	\$ 52,728
	<u>          </u>	<u>          </u>

The accompanying notes are an integral part of these financial statements

**Table of Contents****ACR GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(in thousands, except per share data)****LIABILITIES AND SHAREHOLDERS' EQUITY**

	February 29, 2004	February 28, 2003
	<u>2004</u>	<u>2003</u>
Current liabilities:		
Current maturities of long-term debt	\$ 283	\$ 316
Current maturities of capital lease obligations	123	87
Accounts payable	18,756	16,967
Accrued liabilities and other liabilities	3,249	2,097
	<u>22,411</u>	<u>19,467</u>
Total current liabilities	22,411	19,467
Revolving line of credit	21,086	20,172
Long-term debt	1,469	1,808
Long-term capital lease obligations	176	95
Deferred taxes	219	
	<u>22,950</u>	<u>22,075</u>
Total long-term obligations	22,950	22,075
Shareholders' equity:		
Preferred stock, \$.01 par, authorized 2,000,000 shares, none outstanding		
Common stock, \$.01 par, authorized 25,000,000 shares, 10,681,294 issued and outstanding in 2004 and 2003	107	107
Additional paid-in capital	41,691	41,691
Accumulated deficit	(28,432)	(30,612)
	<u>13,366</u>	<u>11,186</u>
Total shareholders' equity	13,366	11,186
Total liabilities and shareholders' equity	<u>\$ 58,727</u>	<u>\$ 52,728</u>

The accompanying notes are an integral part of these financial statements

**Table of Contents****ACR GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

	February 29,	February 28,	
	2004	2003	2002
Sales	\$ 174,353	\$ 161,822	\$ 155,490
Cost of sales	135,795	126,149	121,920
Gross profit	38,558	35,673	33,570
Selling, general and administrative expenses	34,106	32,983	31,473
Operating income	4,452	2,690	2,097
Interest expense	1,510	1,731	2,086
Other non-operating (income)	(491)	(474)	(531)
Income before income taxes and cumulative effect of accounting change	3,433	1,433	542
Provision for income taxes:			
Current	743	79	123
Deferred	510	251	
Income before cumulative effect of accounting change	2,180	1,103	419
Cumulative effect of accounting change, net of taxes		(483)	
Net income	\$ 2,180	\$ 620	\$ 419
Basic and dilutive earnings per share:			
Before cumulative effect of accounting change	\$ .20	\$ .10	\$ .04
Cumulative effect of accounting change		(.04)	
	\$ .20	\$ .06	\$ .04

The accompanying notes are an integral part of these financial statements

Table of Contents

## ACR GROUP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(in thousands, except share data)

	No. of shares outstanding	Par Value	Additional Paid-in Capital	Accumulated Deficit	Total
<b>Balance, February 28, 2001</b>	10,681,294	\$ 107	\$ 41,691	\$ (31,651)	\$ 10,147
Net income				419	419
<b>Balance, February 28, 2002</b>	10,681,294	107	41,691	(31,232)	10,566
Net income				620	620
<b>Balance, February 28, 2003</b>	10,681,294	107	41,691	(30,612)	11,186
Net income				2,180	2,180
<b>Balance, February 29, 2004</b>	10,681,294	\$ 107	\$ 41,691	\$ (28,432)	\$ 13,366

The accompanying notes are an integral part of these financial statements

**Table of Contents****ACR GROUP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	February 29,	February 28,	
	2004	2003	2002
<b>Operating activities:</b>			
Net income	\$ 2,180	\$ 620	\$ 419
Adjustments to reconcile net income to net cash provided by (used in)			
<b>Operating activities:</b>			
Depreciation	969	1,168	1,133
Amortization	13	94	300
Provision for doubtful accounts	696	418	704
Gain on sale of assets	(27)	(7)	(21)
Deferred income taxes	510		
Cumulative effect of accounting change		483	
<b>Changes in operating assets and liabilities:</b>			
Accounts receivable	(3,614)	1,238	(1,586)
Inventory	(3,623)	990	(2,155)
Prepaid expenses and other assets	(315)	114	238
Accounts payable	1,811	(2,445)	2,265
Accrued expenses and other liabilities	1,154	70	189
<b>Net cash provided by (used in) operating activities</b>	<b>(246)</b>	<b>2,743</b>	<b>1,486</b>
<b>Investing activities:</b>			
Purchase of property and equipment	(528)	(636)	(766)
Proceeds from disposition of assets	281	88	61
<b>Net cash used in investing activities</b>	<b>(247)</b>	<b>(548)</b>	<b>(705)</b>
<b>Financing activities:</b>			
Proceeds from long-term debt	914	191	888
Payments on long-term debt	(473)	(2,411)	(1,711)
<b>Net cash provided by (used in) financing activities</b>	<b>441</b>	<b>(2,220)</b>	<b>(823)</b>
<b>Net decrease in cash</b>	<b>(52)</b>	<b>(25)</b>	<b>(42)</b>
Cash at beginning of year	104	129	171
<b>Cash at end of year</b>	<b>\$ 52</b>	<b>\$ 104</b>	<b>\$ 129</b>
<b>Schedule of non-cash investing and financing activities:</b>			
<b>Sale of subsidiaries:</b>			
Book value of assets sold	\$ 22	\$	\$
Book value of liabilities sold	22		

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Purchases of property and equipment			
For notes payable		52	
Under capital leases	218	20	19
Supplemental cash flow information:			
Interest paid	\$ 1,510	\$ 1,728	\$ 2,047
Income taxes paid	500	4	10

The accompanying notes are an integral part of these financial statements



**Table of Contents**

**ACR GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(in thousands, except per share data)**

**1 - Description of Business and Summary of Significant Accounting Policies**

*Description of Business*

ACR Group, Inc. (the Company) principal business is the wholesale distribution of heating, ventilating, air conditioning and refrigeration (HVACR) equipment, parts and supplies in the southeastern United States, Texas, Nevada, New Mexico, Colorado and California. Substantially all of the Company's sales are to contractor dealers and institutional end-users.

Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information, allows the aggregation of an enterprise's segments if they are similar. The Company operates in different geographic areas; however, the Company has reviewed the aggregation criteria and determined that the Company operates as one segment based on the high degree of similarity of the following aspects of the Company's operations:

nature of products and services

customer markets served

methods used to acquire and distribute products

economic characteristics that influence the results of operations in different geographical areas

*Principles of Consolidation*

The consolidated financial statements include the accounts of ACR Group, Inc. and its subsidiaries, all of which are wholly owned. All significant intercompany accounts and transactions have been eliminated.

*Use of Estimates*

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The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

### *Revenue Recognition*

The Company's revenues consist of sales of HVACR products. The Company recognizes revenue when the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the amounts recognized are fixed and determinable, and (4) collectibility is reasonably assured.

### *Inventories*

Inventories are valued at the lower of cost or market using the average cost method. Substantially all inventories represent finished goods held for sale. The Company has an arrangement with an HVACR equipment manufacturer and a bonded warehouse agent whereby HVACR equipment is held for sale in bonded warehouses located at the premises of certain of the Company's operations, with payment due only when products are sold. The supplier retains legal title and substantial management control with respect to the consigned inventory. The Company is responsible for damage to and loss of inventory that may occur at its premises. The Company has the ability to return consigned inventory, at its sole discretion, to the supplier for a specified period of time after receipt of the inventory. Such inventory is accounted for as consigned merchandise and is not recorded on the Company's balance sheet. The cost of consigned inventory held in the bonded warehouses was \$5,466 at February 29, 2004 and \$7,693 at February 28, 2003.

**Table of Contents****ACR GROUP, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data)**

The terms of the consignment agreement further provide that the Company may be required to purchase inventory not sold within a specified period of time. Historically, most consigned inventory is sold before the specified purchase date, and the supplier has never enforced its right to demand payment, instead permitted such inventory to remain on consignment. As of February 29, 2004 and February 28, 2003, inventory of approximately \$207 and \$565, respectively, remained on consignment although it had been held in excess of the allowable period of time.

*Vendor Rebates*

The Company receives rebates from certain vendors based on the volume of product purchased from the vendor. The Company records rebates when they are earned, i.e. when specified purchase volume levels are reached. Vendor rebates attributable to unsold inventory are carried as a reduction of the carrying value of inventory until such inventory is sold, at which time the related rebates are used to reduce cost of sales.

*Property and Equipment*

Property and equipment are stated at cost. Depreciation and amortization are provided on the straight-line method over the following estimated useful lives.

Buildings	20-40 years
Leasehold improvements	Primary term of the lease
Furniture and fixtures	5-7 years
Vehicles	3-6 years
Other equipment	3-10 years

*Goodwill*

Goodwill represents the excess cost of companies acquired over the fair value of their tangible net assets. Prior to the adoption of Financial Accounting Standards ( SFAS ) No. 142, Accounting for Goodwill and Other Intangible Assets , goodwill was amortized on a straight-line basis over 40 years. Effective March 1, 2002, the Company adopted SFAS 142 which established new accounting and reporting requirements for goodwill and other intangible assets. Under SFAS 142, all goodwill amortization ceased effective March 1, 2002. Goodwill attributable to each of the Company s reporting units was tested for impairment by comparing the fair value of each reporting unit with its carrying value. These impairment tests are required to be performed at adoption of SFAS 142 and at least annually thereafter. On an ongoing basis (absent any impairment indicators), the Company performs the annual impairment test as of the end of its fiscal year.

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Based on the Company's impairment tests performed upon the adoption of SFAS 142, the Company recognized a charge of \$733, or \$483 net of taxes, to reduce the carrying value of goodwill to its implied fair value. This charge has been recorded as a cumulative effect of change in accounting principle in the Company's first quarter of fiscal year 2003. The Company completed its annual impairment test as of February 29, 2004 in the fourth quarter of fiscal year 2004. This impairment test resulted in no additional impairment charges for the year ended February 29, 2004.

**Table of Contents****ACR GROUP, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data)**

Effect of implementation of SFAS 142:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Net income	\$ 2,180	\$ 620	\$ 419
Pro forma amortization expense, net of taxes			183
Pro forma net income	<u>\$ 2,180</u>	<u>\$ 620</u>	<u>\$ 602</u>
Earnings per share	\$ .20	\$ .06	\$ .04
Effect of implementation of SFAS 142 on earnings per share			.02
Pro forma earnings per share	<u>\$ .20</u>	<u>\$ .06</u>	<u>\$ .06</u>

*Income Taxes*

The Company and its subsidiaries file a consolidated federal income tax return. The Company uses the liability method in accounting for income taxes. Under the liability method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

*Stock-Based Compensation*

In accordance with the provisions of SFAS 123, *Accounting for Stock-based Compensation*, the Company has elected to follow the Accounting Principles Board Opinion (APB) 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its employees stock-based compensation plans. Under APB 25, if the exercise price of employee stock options equals or exceeds the fair value of the underlying stock on the date of grant, no compensation expense is recognized.

Had compensation expense been determined consistent with SFAS 123, the Company's net income and earnings per share would have been changed to the following pro forma amounts:

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	Year Ended		
	February 29 or 28,		
	2004	2003	2002
Net income applicable to common shareholders as reported	\$ 2,180	\$ 620	\$ 419
Total stock-based employee compensation expense under fair value method for all awards, net of tax	(19)	(41)	(157)
Pro forma income applicable to common shareholders	\$ 2,161	\$ 579	\$ 262
Basic and diluted earnings per share:			
As reported	\$ .20	\$ .06	\$ .04
Pro forma	.20	.05	.02

The fair value of each option grant under the Company plans for the three years ended February 29, 2004 was estimated using the Black-Scholes options pricing model using the following assumptions:

Expected life of 5 to 8 years

No expected dividend yield

**Table of Contents**

**ACR GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except per share data)**

Expected volatility of .669 for all years in which options were granted, representing 48 periods ending March 31, 2002.

Risk-free interest rate of 5.0% in each fiscal period in which options were granted, representing an approximate average yield over the option periods presented

No options were granted during fiscal 2004, 2003 or 2002.

*Supplier/Sources of Supply*

The Company currently purchases a majority of its HVACR equipment and repair parts from two primary suppliers. Purchases from such suppliers comprised 38% of all purchases made in fiscal 2004, 34% in fiscal 2003 and 36% in fiscal 2002. The Company has not encountered any significant difficulty to date in obtaining equipment and repair parts to support its operations at current or expected near-term future levels. Any significant interruption by such a manufacturer, or a termination of a distributor agreement, could temporarily disrupt the operations of certain subsidiaries. The Company believes that its relationships with suppliers of complementary equipment products are a mitigating factor against this risk.

*Reclassifications*

Certain reclassifications were made to the prior years' financial statements to conform with current year presentation.

*Recent Accounting Issues*

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." The Interpretation requires certain guarantees to be recorded at fair value and also requires a guarantor to make certain disclosures regarding guarantees. The Interpretation's initial recognition and initial measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements became effective for the Company's first quarter of 2004. The adoption of the statement had no material impact on the Company's financial position or results of operations.

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In January 2003, the Emerging Issues Task Force (EITF) reached a final consensus on EITF Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor . EITF 02-16 clarifies certain aspects for accounting and recording of consideration received from vendors. Certain provisions of the EITF are effective for fiscal years beginning after December 15, 2002, and other provisions of the EITF are effective for arrangements entered into after November 21, 2003. The Company s accounting for consideration received from vendors is consistent with the provisions of EITF 02-16 as of February 29, 2004.

In January 2003, the FASB issued Interpretation 46, Consolidation of Variable Interest Entities. In general, a variable interest entity is a corporation, partnership, trust, or other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. Interpretation 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity s activities or entitled to receive a majority of the entity s residual returns or both. The Interpretation is effective for all Variable Interest Entities created after January 31, 2003, and is effective for special purpose entities created before February 1, 2003 for the first reporting period after December 15, 2003 and for non-special purpose entities for the first reporting period beginning after March 15, 2004. The adoption of the Interpretation did not have nor is expected to have a material impact on its financial statements.



**Table of Contents****ACR GROUP, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data)****2 - Property and Equipment**

Property and equipment consisted of the following at the end of February:

	<u>2004</u>	<u>2003</u>
Land	\$ 311	\$ 311
Building and leasehold improvements	3,759	3,684
Furniture and fixtures	276	262
Vehicles	1,089	1,150
Other equipment	5,322	5,379
	<u>10,757</u>	<u>10,786</u>
Less: accumulated depreciation	(6,296)	(5,831)
Net property and equipment	<u>\$ 4,461</u>	<u>\$ 4,955</u>

Capitalized lease assets of \$562 and \$586 together with accumulated amortization of \$169 and \$281 are included in property and equipment as of February 29, 2004 and February 28, 2003. Amortization expense is included with depreciation expense.

**3 - Debt**

Debt is summarized as follows at the end of February:

	<u>2004</u>	<u>2003</u>
Revolving line of credit	\$ 21,086	\$ 20,172
Real estate loan	529	607
Equipment term loan	419	627
Note payable to sellers of real property	757	778
Notes payable to sellers of companies acquired		25

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Other	47	87
	<u>22,838</u>	<u>22,296</u>
Less current maturities	(283)	(316)
	<u>22,555</u>	<u>21,980</u>
Long-term debt, less current maturities	\$ 22,555	\$ 21,980

The Company has a loan agreement ( Agreement ) with a commercial bank ( Bank ) that provides a \$25 million revolving credit facility and additional credit facilities for the purchase of both real estate and capital assets. The Agreement terminates in May 2005, but is automatically extended for one-year periods unless either party gives notice of termination to the other. Restrictive covenants of the Agreement prohibit the Company from paying dividends, prepaying any subordinated indebtedness or incurring certain other debt without the Bank s consent, and also requires the Company to maintain certain financial ratios. As of February 29, 2004, the Company was in compliance with all of the required financial ratios.

The interest rate on borrowings under the revolving credit facility is based on either the Bank s prime rate or LIBOR and varies depending on the Company s leverage ratio, as defined, determined quarterly. As of February 29, 2004, the applicable interest rate was the prime rate or LIBOR plus 2.75%, and the Company had elected the LIBOR option for substantially all amounts outstanding under the facility. The Company has elected to fix the interest rate on \$8 million of outstanding borrowings under the facility, and the balance of outstanding borrowings bears interest at a floating rate. At February 29, 2004, the average interest rate on all borrowings under the facility was 5.80%. Borrowings under the revolving credit facility are limited to 85% of eligible

**Table of Contents**

**ACR GROUP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except per share data)**

accounts receivable and 50% of eligible inventory amounts (which increases to 65% of eligible inventory amounts during certain specified months of the year). At February 29, 2004, the Company's available credit under the facility was approximately \$2.3million.

The Agreement provides a capital expenditure term loan facility of \$1 million for capital assets. As of February 29 2004, the Company had borrowed \$856 under the capital expenditure facility. Of such borrowings, \$419 was outstanding at February 29, 2004, and is repaid in equal monthly principal installments of \$14, plus interest. The Agreement also provides for financing the purchase of certain real estate and improvements. At February 29, 2004, the Company had indebtedness to the Bank for real estate loans of \$529, secured by a deed of trust on both the land and building occupied by two branch facilities in the Houston area, which is repaid in equal monthly principal installments of \$6, plus interest. Both the real estate and the capital expenditures facilities bear interest at a variable rate, which were the prime rate or LIBOR plus 2.75% at February 29, 2004.

In fiscal 2003, the Company repaid its outstanding indebtedness to The Catalyst Fund, Ltd. and an affiliate ( Catalyst ) in the amount of \$469, all of which was subordinated to the Bank. Subsequent to the repayment of such indebtedness, the Company and Catalyst entered into a settlement with respect to warrants held by Catalyst for 925,000 shares of the Company's common stock.

In August 2000, the Company purchased real estate in Gainesville, Florida to be occupied as a branch operation for approximately \$957. Of the purchase price, the sellers financed \$825 for a term of 25 years at an interest rate of 8.25% per annum. The note is secured by a deed of trust on the real estate and all improvements.

A note payable to a seller incurred in connection with an acquisition, which was payable in installments over three years, was repaid in full during fiscal 2004.

Based upon the borrowing rates currently available to the Company for debt instruments with similar terms and average maturities, the carrying value of long-term debt approximates fair value.

Future maturities of debt are \$283 in 2005 \$21,395 in 2006, \$180 in 2007, \$107 in 2008, \$109 in 2009, and \$764 after 2010.

**4 - Lease Commitments**

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The Company leases warehouse and office equipment and vehicles under capital leases. Future minimum lease payments under capital leases are as follows:

Year ended February 28 or 29,	Capital lease payments
2005	\$ 140
2006	106
2007	72
2008	6
2009	3
Total minimum lease payments	327
Less amounts representing interest	(28)
Present value of future minimum lease payments	299
Less current maturities of capital lease obligations	(123)
Long-term obligations under capital leases	\$ 176

**Table of Contents****ACR GROUP, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data)**

Additionally, the Company leases its corporate offices, office and warehouse space occupied by its HVACR operations and office equipment and various vehicles under non-cancelable operating lease agreements that expire at various dates through 2012. The leases for its branch facilities often require that the Company pay the taxes, insurance and maintenance expenses related to the leased properties. Certain of the Company's lease agreements include renewal and/or purchase options. Future minimum lease payments under such leases are \$5,195 in 2005, \$4,177 in 2006, \$3,243 in 2007, \$2,402 in 2008 and \$3,526 thereafter.

Rental expenses were \$5,405, \$4,444 and \$4,668 in 2004, 2003 and 2002, respectively.

**5 - Income Taxes**

Federal and state income tax provisions are as follows:

	Year Ended		
	February 29 or 28,		
	2004	2003	2002
	_____	_____	_____
Federal			
Current	\$ 573	\$ 20	\$ 16
Deferred	510	227	
State			
Current	170	59	107
Deferred		24	
	_____	_____	_____
	\$ 1,253	\$ 330	\$ 123
	_____	_____	_____

The difference between the income tax provision computed at the statutory federal income tax rate and the financial statement provision for taxes is summarized below:

Year Ended

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	February 29 or 28,		
	2004	2003	2002
	<u>          </u>	<u>          </u>	<u>          </u>
Tax at statutory rate	\$ 1,167	\$ 487	\$ 184
Increase (reduction) in tax expense Resulting from:			
Change in valuation allowance	(102)	(961)	(804)
Nondeductible expenses	60	90	96
State income taxes	128	79	107
Expired tax credits and expired NOL carryforwards		635	540
	<u>          </u>	<u>          </u>	<u>          </u>
Actual income tax provision	\$ 1,253	\$ 330	\$ 123
	<u>          </u>	<u>          </u>	<u>          </u>

**Table of Contents****ACR GROUP, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data)**

The Company recognizes a tax benefit from a net operating loss carryforward if it is more likely than not that such benefit will ultimately be realized. Such a tax benefit is recorded on the balance sheet as a deferred tax asset. The deferred tax assets and liabilities consist of the following as of February 29, 2004 and February 28, 2003:

	<u>2004</u>	<u>2003</u>
Deferred tax assets:		
NOL carryforwards	\$ 205	\$ 674
Section 263A capitalization	454	492
Allowance for doubtful accounts	365	274
Alternative minimum tax credit		71
Accrued vacation	185	179
Fixed asset depreciation	164	114
Accrued medical claims	93	
Other	69	33
	<u>1,535</u>	<u>1,837</u>
Total deferred tax assets	1,535	1,837
Deferred tax liabilities:		
Goodwill and other amortization	(472)	(162)
	<u>1,063</u>	<u>1,675</u>
Net total temporary difference	1,063	1,675
Valuation allowance	(115)	(217)
	<u>948</u>	<u>1,458</u>
Net deferred tax assets	\$ 948	\$ 1,458

The Company applied net operating loss carryforwards of \$1,300 to offset taxable income during the fiscal 2004. The Company has a valuation allowance of \$115 to offset California state tax net operating loss carryforwards that have been suspended by the state.

**6 - Stock Option Agreements and Equity Transactions**

Pursuant to employment contracts that were effective in 1998, both the President and the Chief Financial Officer of the Company received options to purchase 300,000 and 100,000 shares of the Company's common stock ( "Stock" ), respectively, at \$2.24 per share. Such options would have vested in 2006. Both officers forfeited their respective options, unexercised, in fiscal 2004.

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Effective March 1, 2004, both the Chief Financial Officer and the General Counsel of the Company entered into employment contracts that each provide for the contingent issuance of 500,000 shares of Stock upon both continuation of employment and attainment of specified financial performance objectives by the Company. Up to 125,000 shares will vest for each officer on each of the four succeeding anniversary dates of the grant if the performance objectives are also satisfied. Any such shares not fully vested as of March 1, 2009, will be forfeited and returned to the Company. As of March 1, 2004, the Company had not attained any of the performance objectives required to vest Stock under the employment agreements. Effective March 1, 2004, the two outside directors of the Company each received restricted stock grants of 42,000 shares, subject to continuation of service as a director for four years. Such shares will vest annually pro-rata over such period.

The Company has a stock option plan for key employees and directors of the Company and its subsidiaries. The plan provides for the granting of up to 500,000 non-qualified and/or incentive stock options. At February 29, 2004, 227,500 shares of common stock were available for future grants. Options granted under the plan are vested ratably over three years.



**Table of Contents****ACR GROUP, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except per share data)**

A summary of the Company's stock option activity and related information follows:

	Year Ended February 29 or 28,					
	2004		2003		2002	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding -						
Beginning of year	715,500	\$ 1.81	905,000	\$ 1.94	941,000	\$ 1.92
Granted						
Exercised						
Forfeited	(443,000)	2.16	(189,500)	2.40	(36,000)	1.53
Outstanding -						
End of year	272,500	1.25	715,500	1.81	905,000	1.94
Exercisable-						
End of year	272,500	1.25	646,833	1.89	322,667	1.98

Outstanding options at February 29, 2004 that are exercisable have a weighted average contractual life remaining of 1.75 years.

**7 - Profit Sharing Plan**

The Company has a qualified profit sharing plan ( Plan ) under Section 401(k) of the Internal Revenue Code. The Plan is open to all eligible employees. The Company matches 50% of the participant's contributions, not to exceed 3% of each participant's compensation. Company contributions to the Plan were \$251, \$261 and \$258 for fiscal 2004, 2003 and 2002, respectively.

**8 - Earnings per Share**

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The numerator used in the calculations of both basic and diluted earnings per share for all periods presented was net income. The denominator for each period presented was determined as follows:

	Year ended February 29 or 28,		
	2004	2003	2002
<b>Denominator:</b>			
Denominator for basic earnings per share- weighted average shares	10,681,294	10,681,294	10,681,294
<b>Effect of dilutive securities:</b>			
Employee stock options			
Warrants			5,377
			5,377
Dilutive potential common shares			5,377
			5,377
Denominator for diluted earnings per share adjusted weighted average shares and assumed conversions	10,681,294	10,681,294	10,686,671
			10,686,671

Table of Contents

## ACR GROUP, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(in thousands, except per share data)

## 9 - Quarterly Results (Unaudited)

	Quarter			
	First	Second	Third	Fourth
<i>Fiscal year ended February 29, 2004</i>				
Sales	\$ 42,316	\$ 51,543	\$ 42,187	\$ 38,307
Gross profit	9,305	11,348	9,130	8,776
Net income	\$ 488	\$ 1,479	\$ 286	\$ (73)
Earnings per common share basic and diluted	\$ .05	\$ .13	\$ .03	\$ (.01)
<i>Fiscal year ended February 28, 2003</i>				
Sales	\$ 42,869	\$ 47,810	\$ 37,902	\$ 33,241
Gross profit	9,210	10,614	8,480	7,834
Income before cumulative effect of accounting change	459			
Cumulative effect of accounting change, net of taxes	(483)			
Net income	\$ (24)	\$ 1,152	\$ (107)	\$ (399)
Earnings per common share basic and diluted:				
Before cumulative effect of accounting change	\$ (.04)	\$ .11	\$ (.01)	\$ (.03)
Cumulative effect of accounting change	\$ (.04)	\$	\$	\$
	\$	\$ .11	\$ (.01)	\$ (.03)
<i>Fiscal year ended February 28, 2002</i>				
Sales	\$ 39,709	\$ 46,509	\$ 37,007	\$ 32,265
Gross profit	8,602	9,920	7,981	7,426
Net income	\$ 396	\$ 1,044	\$ (336)	\$ (685)
Earnings per common share basic and diluted	\$ .04	\$ .10	\$ (.03)	\$ (.06)

**Table of Contents**

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None

**PART III**

**Item 10. Directors and Executive Officers of the Registrant.**

Incorporated by reference.

**Item 11. Executive Compensation.**

Incorporated by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management.**

Incorporated by reference.

**Item 13. Certain Relationships and Related Transactions.**

Incorporated by reference.

**Table of Contents**

**PART IV**

**Item 14. Controls and Procedures.**

As of February 29, 2004, an evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the Chief Executive Officer and the Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of February 29, 2004. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to February 29, 2004.

**Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.**

(a)(1) Financial Statements included in Item 8.

See Index to Financial Statements of ACR Group, Inc. set forth in Item 8, Financial Statements and Supplementary Data.

(a)(2) Index to Financial Statement Schedules included in Item 15.

The following financial statement schedule for the years ended February 29, 2004, February 28, 2003 and 2002 is included in this report:

Schedule II - Valuation and Qualifying Accounts

All other schedules are omitted because they are not applicable or the required information is included in the financial statements or notes thereto.

(a)(3) Exhibits

The following exhibits are filed with or incorporated by reference into this report. The exhibits which are denoted by an asterisk (\*) were previously filed as a part of, and are hereby incorporated by reference from, either (a) Annual Report on Form 10-K for fiscal year ended June 30, 1991 (referred to as 1991 10-K ), or (b) Annual Report on Form 10-K for fiscal year ended February 28, 1993 (referred to as 1993 10-K ), or (c) Annual Report on Form 10-K for fiscal year ended February 28, 1998 (referred to as 1998 10-K ), or (d) Annual Report on Form 10-K for fiscal year ended February 29, 2000 (referred to as 2000 Form 10-K ), (e) Annual Report on Form 10-K for fiscal year ended February 28, 2001 (referred to as 2001 Form 10-K ) or (f) Annual Report on Form 10-K for fiscal year ended February 28, 2002 (referred to as 2002 Form 10-K )

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<u>Exhibit Number</u>	<u>Description</u>
* 3.1	Restated Articles of Incorporation (Exhibit 3.1 to 1991 10-K)
* 3.2	Articles of Amendment to Articles of Incorporation (Exhibit 3.2 to 1993 10-K)
* 3.3	Amended and Restated Bylaws (Exhibit 3.2 to 1991 10-K)
* 3.4	Amendment to Bylaws dated December 8, 1992 (Exhibit 3.4 to 1993 10-K)
* 4.1	Specimen of Common Stock Certificate of ACR Group, Inc. (Exhibit 4.1 to 1993 10-K)
*10.1	Employment Agreement between the Company and Alex Trevino, Jr. dated as of March 1, 1998 (Exhibit 10.1 to 1998 10-K)
*10.2	Stock Option Agreement between the Company and Alex Trevino, Jr. dated as of March 1, 1998 (Exhibit 10.2 to 1998 10-K)

**Table of Contents**

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>
*10.3	Employment Agreement between the Company and Anthony R. Maresca dated as of March 1, 1998 (Exhibit 10.3 to 1998 10-K)
10.3A	Employment Agreement between the Company and Anthony R. Maresca dated as of March 1, 2004
*10.4	Stock Option Agreement between the Company and Anthony R. Maresca dated as of March 1, 1998 (Exhibit 10.4 to 1998 10-K)
*10.5	Registration Rights Agreement by and between the Company, Alex Trevino, Jr. and Anthony R. Maresca (Exhibit 10.5 to 1998 10-K)
*10.6	Note Agreement between The Catalyst Fund, Ltd., as Lender, and the Company, ACR Supply, Inc., Fabricated Systems, Inc. and Heating and Cooling Supply, Inc., as Borrowers, dated as of May 27, 1993 (Exhibit 10.18 to 1993 10-K)
*10.7	First Amendment to Note Agreement by and among The Catalyst Fund, Ltd., the Company, ACR Supply, Inc., Total Supply, Inc. f/k/a Fabricated Systems, Inc., Heating and Cooling Supply, Inc. and West Coast HVAC Supply, Inc., dated as of April 14, 1997 (Exhibit 10.7 to 1998 10-K)
*10.8	Second Amendment and Restated Note Agreement by and between the Company, all subsidiaries of the Company, The Catalyst Fund, Ltd., and Southwest/Catalyst Capital, Ltd., dated as of January 28, 1998 (Exhibit 10.8 to 1998 10-K)
*10.9	Warrant for the Purchase of 750,000 Shares of Common Stock of the Company issued to The Catalyst Fund, Ltd. dated January 28, 1998 (Exhibit 10.9 to 1998 10-K)
*10.10	Warrant for the Purchase of 50,000 Shares of Common Stock of the Company issued to The Catalyst Fund, Ltd. dated January 28, 1998 (Exhibit 10.10 to 1998 10-K)
*10.11	Warrant for the Purchase of 125,000 Shares of Common Stock of the Company issued to Southwest/Catalyst Capital, Ltd. dated January 28, 1998 (Exhibit 10.11 to 1998 10-K)
*10.12	Registration Rights Agreement between The Catalyst Fund, Ltd. and the Company dated as of January 28, 1998 (Exhibit 10.12 to 1998 10-K)
*10.13	Registration Rights Agreement between Southwest/Catalyst Capital, Ltd. and the Company dated as of January 28, 1998 (Exhibit 10.13 to 1998 10-K)
*10.14	Amended and Restated Loan and Security Agreement between the Company and Bank of America, N.A. dated as of May 25, 2000. (Exhibit 10.15A to 2000 10-K)
*10.15	First Amendment to Amended and Restated Loan and Security Agreement between the Company and Bank of America, N.A. dated as of March 30, 2001. (Exhibit 10.15 to 2001 10-K)
*10.15A	Second Amendment to Amended and Restated Loan and Security Agreement between the Company and Bank of America, N.A. dated as of November 30, 2001. (Exhibit 10.15A to 2002 10-K)
*10.16	1996 Stock Option Plan of ACR Group, Inc. (Exhibit 4 to RS 333-16325)
10.17	Director Restricted Stock Agreement between the Company and Roland H. St. Cyr dated as of March 1, 2004.
10.18	Director Restricted Stock Agreement between the Company and Alan D. Feinsilver dated as of March 1, 2004

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**Table of Contents**

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>
10.19	Employment Agreement between the Company and A. Stephen Trevino dated as of March 1, 2004
21.1	Subsidiaries of the Company
23.1	Consent of Independent Auditors
31.1	Certificate of the Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 dated January 14, 2004,
31.2	Certificate of the Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 dated January 14, 2004, 2003,
32.1	Certification from the Chief Executive Officer of ACR Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification from the Chief Financial Officer of ACR Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K.

No report on form 8-K was filed during the period from December 1, 2003 to February 29, 2004.

(c) Exhibits

See Item 14(a)(3), above.



Table of Contents

## SCHEDULE II

## ACR GROUP, INC. AND SUBSIDIARIES

## VALUATION AND QUALIFYING ACCOUNTS

(in thousands)

Description	Balance at beginning of period	Charged to costs and expenses	Allowance written off	Balance at end of period
<b>Year ended February 29, 2004:</b>				
Allowance for doubtful accounts:				
Accounts receivable	\$ 685	\$ 696	\$ 588	\$ 793
<b>Year ended February 28, 2003:</b>				
Allowance for doubtful accounts:				
Accounts receivable	\$ 844	\$ 418	\$ 577	\$ 685
<b>Year ended February 28, 2002:</b>				
Allowance for doubtful accounts:				
Accounts receivable	\$ 670	\$ 704	\$ 530	\$ 844

