

Edgar Filing: ACR GROUP INC - Form 10-Q

ACR GROUP INC  
Form 10-Q  
October 15, 2002

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

FORM 10-Q

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

For the quarterly period ended August 31, 2002

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  No

Shares of Common Stock outstanding at September 30, 2002 - 10,681,294.

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PART I - FINANCIAL INFORMATION

Item 1. - Financial Statements

ACR GROUP, INC. AND SUBSIDIARIES

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## CONDENSED CONSOLIDATED BALANCE SHEETS (In thousands)

### ASSETS

	August 31, 2002	February 28, 2002
	-----	-----
	(Unaudited)	
Current assets:		
Cash	\$ 108	\$ 129
Accounts receivable, net	20,636	16,858
Inventory	26,393	25,987
Prepaid expenses and other	327	275
Deferred income taxes	806	487
	-----	-----
Total current assets	48,270	43,736
	-----	-----
Property and equipment, net of accumulated depreciation	5,031	5,405
Deferred income taxes	454	973
Goodwill, net of accumulated amortization	5,258	5,991
Other assets	591	525
	-----	-----
	\$ 59,604	\$ 56,630
	=====	=====

### LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Current maturities of long-term debt and capital lease obligations	\$ 648	\$ 898
Accounts payable	21,289	19,411
Accrued expenses and other liabilities	2,637	2,027
	-----	-----
Total current liabilities	24,574	22,336
Long-term debt and capital lease obligations, less current maturities	23,336	23,728
	-----	-----
Total liabilities	47,910	46,064
	-----	-----
Shareholders' equity:		
Common stock	107	107
Additional paid-in capital	41,691	41,691
Accumulated deficit	(30,104)	(31,232)
	-----	-----
Total shareholders' equity	11,694	10,566
	-----	-----
	\$ 59,604	\$ 56,630
	=====	=====

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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  
(In thousands, except per share amounts)  
(Unaudited)

	Six months ended August 31,		Three months ended August 31,	
	2002	2001	2002	2001
Sales	\$ 90,679	\$ 86,218	\$ 47,810	\$ 46,509
Cost of sales	70,855	67,696	37,196	36,589
	19,824	18,522	10,614	9,920
Gross profit				
Selling, general and administrative expenses	(16,954)	(15,791)	(8,691)	(8,163)
	2,870	2,731	1,923	1,757
Operating income				
Interest expense	(916)	(1,183)	(468)	(549)
Other non-operating income	216	231	101	140
	2,170	1,779	1,556	1,348
Income before income taxes				
Provision for income taxes:				
Current	110	139	80	104
Deferred	449	200	324	200
	1,611	1,440	1,152	1,044
Income before cumulative effect of accounting change				
Cumulative effect of change in accounting principle, net of tax	(483)	--	--	--
	\$ 1,128	\$ 1,440	\$ 1,152	\$ 1,044
Net income				
Basic and diluted earnings (loss) per share:				
Earnings per share before cumulative effect of accounting change	.15	.13	.11	.10
Cumulative effect of accounting change	(.04)	--	--	--
	\$ .11	\$ .13	\$ .11	\$ .10
Earnings per share				
Weighted average shares outstanding:				

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Basic	10,681 =====	10,681 =====	10,681 =====	10,681 =====
Diluted	10,681 =====	10,692 =====	10,681 =====	10,703 =====

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 CASH FLOWS  
(In thousands)  
(Unaudited)

	Six months ended August 31,	
	2002	2001
	-----	-----
Operating activities:		
Net income	\$ 1,128	\$ 1,440
Adjustments to reconcile net income to net cash provided by operating activities:		
Cumulative effect of change in accounting principle	483	--
Depreciation and amortization	598	710
Deferred income tax expense	449	200
Other	(6)	(10)
Changes in operating assets and liabilities:		
Accounts receivables	(3,773)	(5,533)
Inventory	(406)	(1,469)
Prepaid expenses and other assets	(121)	290
Accounts payable	1,878	4,264
Accrued expenses and other liabilities	610	539
	-----	-----
Net cash provided by operating activities	840	431
	-----	-----
Investing activities:		
Acquisition of property and equipment	(206)	(480)
Proceeds from disposition of assets	7	10
	-----	-----
Net cash used in investing activities	(199)	(470)
	-----	-----
Financing activities:		
Net (payments) borrowings on revolving credit facility	(380)	606
Payments on long-term debt	(282)	(471)
	-----	-----
Net cash provided by (used in) financing activities	(662)	135
	-----	-----

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Net (decrease) increase in cash	(21)	96
Cash at beginning of year	129	171
	-----	-----
Cash at end of period	\$ 108	\$ 267
	=====	=====
Supplemental disclosure of cash flow information:		
Cash paid for		
Interest	901	1,109
Income taxes	29	10

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

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### ACR GROUP, INC. AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

##### 1 - Basis of Presentation

The accompanying unaudited condensed historical financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States. Accordingly, they do not include all of the information and footnotes required for complete financial statements, and therefore should be reviewed in conjunction with the financial statements and related notes thereto contained in the Company's annual report for the year ended February 28, 2002 filed on Form 10-K with the Securities and Exchange Commission. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Actual operating results for the three-month and six-month periods ended August 31, 2002, are not necessarily indicative of the results that may be expected for the fiscal year ended February 28, 2003.

##### 2 - Summary of Significant Accounting Policies

For a description of these policies, refer to Note 1 of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended February 28, 2002.

##### 3 - Contingent Liabilities

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. As of August 31, 2002, the cost of such inventory held in the bonded warehouses was \$7,203,000.

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

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date, and the supplier has never enforced its right to demand payment, instead permitting such inventory to remain on consignment. As of August 31, 2002, inventory of approximately \$700,000 remained on consignment although it had been held in excess of the allowable period of time.

### 4 - New Accounting Pronouncements

Effective March 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 144 (SFAS 144), "Accounting for the Impairment or Disposal of Long-Lived Assets." The new standard requires one model of accounting for long-lived assets to be disposed of and broadens the definition of discontinued operations to include a component of a segment. The adoption of SFAS 144 did not have any significant impact on its financial position or results of operations.

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Effective March 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets," which establishes 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 the three and six-month periods ended August 31, 2002 would have otherwise been \$57,000 and \$114,000 respectively. Material amounts of recorded goodwill attributable to each of our applicable subsidiaries were tested for impairment by comparing the fair value of each subsidiary with its carrying value. Fair value was determined using both discounted cash flows and internal rates of return. These impairment tests must be performed upon adoption of SFAS No. 142 and at least annually thereafter. Significant estimates used in the methodologies include estimates of future cash flows and both future short-term and long-term growth rates. On an ongoing basis (absent any impairment indicators), we expect to perform our impairment tests during the fourth fiscal quarter of each year.

Based on our initial impairment tests, we recognized a charge of \$483,000 (\$0.04 per share) in the first quarter of fiscal 2003 to reduce the carrying value of goodwill of Lifetime Filter, Inc. to its implied fair value. This impairment is a result of adopting a fair value approach, under SFAS No. 142, to testing impairment of goodwill as compared to the previous method utilized in which evaluations of goodwill impairment were made by comparing estimated future discounted cash flows to the carrying amount of the assets. Under SFAS No. 142, the impairment adjustment recognized upon adoption of the new rules was reflected as a cumulative effect of change in accounting principle in our income statement for the first quarter of fiscal 2003. Impairment adjustments recognized after adoption, if any, generally are required to be recognized as operating expenses.

The unaudited results of operations presented below for the six-month and three-month periods ended August 31, 2002, and adjusted results of operations for the same periods ended August 31, 2001, reflect the operations of the Company had we adopted the non-amortization provisions of SFAS No. 142 effective March 1, 2001: (in thousands, except per share amounts)

Six months ended August 31,		Three months ended August 31,	
2002	2001	2002	2001
-----	-----	-----	-----

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Net income	\$1,128	\$1,440	\$1,152	\$1,044
Add: Cumulative effect of change in accounting principle, net of tax	483	--	--	--
Add: Goodwill amortization, net of tax	--	76	--	38
	-----	-----	-----	-----
Adjusted net income	\$1,611	\$1,516	\$1,152	\$1,082
	=====	=====	=====	=====
Basic and diluted earnings per share:				
Reported net income	.11	.13	.11	.10
Cumulative effect of change in accounting principle, net of tax	.04	-	-	-
Goodwill amortization, net of tax	-	.01	-	-
	-----	-----	-----	-----
Adjusted net income	\$ .15	\$ .14	\$ .11	\$ .10
	=====	=====	=====	=====

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5 - Income Taxes

The provision for current income taxes consists principally of federal alternative minimum taxes and state income taxes. The provision for deferred taxes consists of a reduction of current deferred benefits expected to be realized as a result of the anticipated utilization of net operating loss carryforwards in fiscal 2003. The reduction is based on applying an effective tax rate of 21.3% to current year taxable income. The Company has net operating loss and tax credit carryforwards which offset substantially all of its federal taxable income.

6 - Debt

The Company has a credit arrangement with a commercial bank ("Bank") that includes both a revolving credit facility and a term loan facility for capital expenditures. The maximum amounts that may be borrowed under such facilities are \$25 million and \$1 million, respectively. At August 31, 2002, the Company had available credit under such facilities of \$2.3 million and \$0.4 million, respectively. The credit facilities mature in May 2004, and are automatically extended for one-year periods unless either party gives notice of termination to the other.

7 - Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share for the six months and three months ended August 31, 2002 and 2001 (in thousands, except earnings per share information):

Six Months Ended		Three Months Ended	
-----		-----	
August 31,		August 31,	
-----		-----	
2002	2001	2002	2001
-----	-----	-----	-----

Numerator:

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Net income	\$ 1,128	\$ 1,440	\$ 1,152	\$ 1,044
Numerator for basic and diluted earnings per share - income available to common stockholders	\$ 1,128	\$ 1,440	\$ 1,152	\$ 1,044
	=====	=====	=====	=====
Denominator:				
Denominator for basic earnings per share - weighted average shares	10,681	10,681	10,681	10,681
Effect of dilutive securities:				
Warrants	0	11	0	22
	-----	-----	-----	-----
Dilutive potential common shares	0	11	0	22
	-----	-----	-----	-----
Denominator for diluted earnings per share - adj weighted average shares and assumed conversions	10,681	10,692	10,681	10,703
	=====	=====	=====	=====
Basic earnings per share	\$ .11	\$ .13	\$ .11	\$ .10
	=====	=====	=====	=====
Dilutive earnings per share	\$ .11	\$ .13	\$ .11	\$ .10
	=====	=====	=====	=====

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### ACR GROUP, INC. AND SUBSIDIARIES

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

##### INTRODUCTION

ACR Group, Inc. and its subsidiaries (collectively, the "Company") is an independent distributor of heating, air conditioning and refrigeration ("HVACR") equipment and related parts and supplies. The Company is among the ten largest such distributors in the United States. Substantially all of the Company's sales are to contractor dealers and institutional end-users. Generally accepted accounting principles allow the aggregation of an enterprise's segment if they are similar. Although the Company operates in different geographic areas, we have reviewed the aggregation criteria and determined that the Company operates as a single segment based on the high degree of similarity of the Company's operations.

This report on Form 10-Q includes certain statements that may be deemed to be "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934. 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. Such risks and

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uncertainties may include the availability of debt or equity capital to fund the Company's working capital requirements, unusual weather conditions, the effects of competitive pricing and general economic factors. Our expectations and beliefs are expressed in good faith and we believe there is a reasonable basis for them, but there can be no assurance that our 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.

### COMPARISON OF RESULTS OF OPERATIONS FOR THE SIX-MONTH AND THREE MONTH PERIODS ENDED AUGUST 31, 2002 AND AUGUST 31, 2001

#### Six Months Ended August 31, 2002 compared to August 31, 2001

The Company recognized net income of \$1,128,000 for the six-month period ended August 31, 2002 (fiscal 2003) compared to net income of \$1,440,000 for the six-month period ended August 31, 2001 (fiscal 2002). Comparability between fiscal 2003 and fiscal 2002 is affected by two accounting developments. The Company adopted SFAS No. 142 as of March 1, 2002 (see New Accounting Pronouncements, below) and has recorded deferred income tax charges to reduce the Company's deferred tax assets. Excluding these items, net income in fiscal 2003 would have been \$2,060,000, compared to \$1,640,000 in fiscal 2002, an increase of 26%. The increase in such income was attributable to lower interest costs and an improvement in the Company's gross margin percentage in the current year.

Consolidated sales increased 5% during the six-month period ended August 31, 2002 compared to the same period in 2001. Sales growth exceeded 20% in Tennessee and Florida, with single-digit percentage increases in all other trade areas

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except for Colorado. Fiscal 2003 sales at the Company's business unit based in Colorado declined 8% as continued economic weakness curtailed new home starts and dampened demand for the Company's products. Same-store sales in the first eight months of calendar 2002 increased 7% over 2001, the same percentage increase in industry-wide product shipments during the same period based on data compiled by a leading industry trade association.

The Company's gross margin percentage on sales was 21.9% for the six-months ended August 31, 2002, compared to 21.5% for the same period in 2001. The increase in gross margin percentage was attributable to the Company's continuing efforts to reduce the net purchase cost of inventory through national buying arrangements and consolidation of decentralized purchasing to designated suppliers, and to refinements in customer pricing models. Gross margin improvement was particularly evident at certain branch operations opened in the past two years. These margin improvement initiatives were partially offset by reduced demand for sheet metal products manufactured by the Colorado business unit for use in new home construction. The lower demand resulted in a lower absorption rate of fixed manufacturing costs and, accordingly, a lower gross margin percentage. The aggregate gross margin percentage of all of the Company's other operations increased to 21.3% in the six-month period ended August 31, 2002, compared to 20.1% in the preceding year.

Selling, general and administrative ("SG&A") expenses increased 7% in the

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six-month period ended August 31, 2002 compared to the same period in 2001, principally from increased payroll, insurance costs and rent expense. Expressed as a percentage of sales, SG&A expenses increased in the six-month period from 18.3% in 2001 to 18.7% in 2002.

Interest expense decreased 23% from 2001 to 2002 as a result of lower average interest rates on the Company's variable rate debt. As a percentage of sales, interest expense decreased to 1.0% in 2002 from 1.4% in 2001. Average outstanding debt decreased 5% from 2001 to 2002.

The current provision for income taxes consists principally of federal alternative minimum taxes and state income taxes. The provision for deferred taxes consists of a reduction of current deferred benefits expected to be realized as a result of the anticipated utilization of net operating loss carryforwards in fiscal 2003. Substantially all of the Company's net operating loss carryforward will either expire, or is expected to be utilized, by the end of fiscal 2004. The Company has estimated a tax rate of 21% to systematically amortize through fiscal 2004 the deferred tax asset related to its net operating loss carryforward. This estimated tax rate is likely to change periodically as the Company re-evaluates its estimate of taxable income through fiscal 2004.

The cumulative effect of the accounting change reflects the result of adopting the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets" as of March 1, 2002. For further explanation, see New Accounting Pronouncements, below.

Three Months Ended August 31, 2002 compared to August 31, 2001

Net income increased to \$1,152,000 in the quarter ended August 31, 2002 from \$1,044,000 in the quarter ended August 31, 2001, an increase of 10%. The Company recorded deferred tax charges in such periods of \$449,000 and \$200,000, respectively, to recognize the utilization of the Company's net operating loss carryforward, as more fully described above. Excluding the effect of such non-cash deferred tax charges, income for the second fiscal quarter increased 19% from 2001 to 2002. As explained in the comparison of six-month results above, the increase in income before taxes for the second quarter was attributable to lower interest costs and an improvement in the gross margin percentage on

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sales.

Both consolidated and same-store sales increased 3% during the quarter ended August 31, 2002 compared to the same quarter in 2001. The trends described above in the six-month comparison also apply for the second fiscal quarter, except that sales in Texas declined 5% compared to 2001. In addition, sales slowed toward the end of the second quarter, as sales in August 2002 actually declined compared to 2001. The slowdown in sales in Texas appears to be related to the economy, as evidenced by a decline in sales to customers involved in residential new construction. The record heat experienced in certain parts of the country during summer 2002 did not occur in the Company's principal market areas. Therefore, while sales peaked as usual in the second fiscal quarter because of demand created by normal summer temperatures, sales were not enhanced by extraordinary weather conditions.

The Company's gross margin percentage on sales was 22.2% for the quarter ended August 31, 2002, compared to 21.3% for the same period in 2001. The increase in the gross margin percentage was attributable to the same factors as mentioned earlier in the six-month analysis.

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Selling, general and administrative ("SG&A") expenses increased 6% in the quarter ended August 31, 2002 compared to the same period in 2001. This increase is consistent with the increase for the six-month period analyzed above. Expressed as a percentage of sales, SG&A expenses increased in the quarter from 17.6% in 2001 to 18.2% in 2002.

Interest expense in the second quarter decreased 15% from 2001 to 2002 as a result of both lower average interest rates on the Company's variable rate debt and a 5% decrease in average outstanding indebtedness. As a percentage of sales, interest expense decreased to 1.0% in 2002 from 1.2% in 2001.

### LIQUIDITY AND CAPITAL RESOURCES

In the six-month period ended August 31, 2002, the Company generated cash flow from operations of \$840,000, compared to \$431,000 in 2001. Gross accounts receivable represented 42 days of gross sales as of August 31, 2002, compared to 44 days at August 31, 2001, reflecting a continuous focus on credit management and active collection efforts in the uncertain economic environment. Inventory at August 31, 2002 was 4% greater than at August 31, 2001, the majority of which consisted of an additional line of HVAC equipment in Texas, reflecting management's aggressive monitoring of inventory levels.

The Company has credit facilities with a commercial bank ("Bank") which include an \$25 million revolving line of credit and a \$1 million term loan facility for capital expenditures. Outstanding borrowings on the revolving credit line change daily depending on cash collections and disbursements. During the six-month period ended August 31, 2002, the Company did not borrow additional funds from its capital expenditure facility. At August 31, 2002, the Company had available credit of \$2.3 and \$0.4 million under the revolving credit facility and the term loan facility, respectively. As of August 31, 2002, borrowings under both credit facilities bear interest at the prime rate or LIBOR plus 2.75%, and the Company had elected the LIBOR option on substantially all outstanding borrowings. Management believes that availability under the revolving credit facility will be adequate to finance the Company's working capital requirements of its existing operations for the foreseeable future.

The Company has approximately \$4.7 million in tax loss carryforwards, of which \$3.4 expires in fiscal 2003. Such operating loss carryforwards will substantially limit the Company's federal income tax liabilities in fiscal

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2003.

### 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

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competitors, and such increases are passed through to customers as an increase in sales prices.

### NEW ACCOUNTING PRONOUNCEMENTS

Effective March 1, 2002, the Company adopted Statement of Financial Standards No. 142, (SFAS 142) "Goodwill and Other Intangible Assets," which establishes 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 the quarter and six-month periods ended August 31, 2002 would have otherwise been \$57,000 and \$114,000, respectively. Material amounts of recorded goodwill attributable to each of our reporting units were tested for impairment by comparing the fair value of each reporting unit with its carrying value. Fair value was determined using discounted cash flows, internal rates of return and market multiples. These impairment tests are required to be performed at adoption of SFAS No. 142 and at least annually thereafter. Significant estimates used in the methodologies include estimates of future cash flows and both future short-term and long-term growth rates. On an ongoing basis (absent any impairment indicators), we expect to perform our impairment tests during our first fiscal quarter.

Utilizing the new criteria, the Company determined that it was appropriate to write off the entire unamortized amount of goodwill associated with its filter manufacturing operation that was acquired in 1997. We reached that conclusion upon consideration of the reporting unit's unprofitability for the last two fiscal years and a substantial shift in both its product sales mix and its customer base since the date of acquisition. Net of taxes, the writeoff amounted to \$483,000, or \$0.04 per share, and in accordance with the new standard, is reported in the income statement for the quarter ended August 31, 2002 as a cumulative effect of a change in accounting principle.

Effective March 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The new standard requires one model of accounting for long-lived assets to be disposed of, and broadens the definition of discontinued operations to include a component of a segment. The adoption of SFAS 144 did not have any significant impact on its financial position or results of operations.

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### 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 Statement of Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements". 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 101 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an

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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.

### 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. One customer represents approximately 2% of consolidated sales, and no other customer comprises 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 2% 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.

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### Item 3. - Quantitative and Qualitative Disclosures About Market Risk

The Company is subject to market risk exposure related to changes in interest rates on its senior credit facility, which includes revolving credit and term notes. These instruments carry interest at a pre-agreed upon percentage point spread from either the prime interest rate or LIBOR. Under its senior credit facility the Company may, as its option, fix the interest rate for certain borrowings based on a spread over LIBOR for 30 days to 6 months. At August 31, 2002 the Company had \$22.7 million outstanding under its credit facilities with the bank, of which \$12.7 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 \$127,000, or \$.01 per share, on an annual basis.

### Item 4. - Statement Regarding Disclosure Controls and Procedures

As of August 31, 2002, 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 August 31, 2002. There have been no significant changes in the Company's internal controls or in other factors that

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could significantly affect internal controls subsequent to August 31, 2002.

### PART II - OTHER INFORMATION

#### Item 4. - Results of Votes of Security Holders

At the Annual Meeting of Shareholders on August 22, 2002, the shareholders of the Company voted on and approved the following issue:

Election of Directors for a term of one year expiring at the next Annual Meeting of Shareholders:

	Shares For	Shares Withheld
	-----	-----
Anthony R. Maresca	9,732,835	47,600
Alan D. Feinsilver	9,769,155	11,280
Roland H. St. Cyr	9,768,355	12,080
A. Stephen Trevino	9,708,835	71,600
Alex Trevino, Jr.	9,730,835	49,600

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

##### (a) Exhibits

99.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.2 Certification of Chief Financial Officer 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.           None

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### 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.

October 15, 2002  
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Date

/s/ Anthony R. Maresca  
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Anthony R. Maresca  
Senior Vice-President and  
Chief Financial Officer

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### CERTIFICATIONS

I, Alex Trevino, Jr., certify that:

- (1) I have reviewed this quarterly report on Form 10-Q of ACR Group, Inc.;
- (2) Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
- (6) The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent

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evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

October 15, 2002

/s/ Alex Trevino, Jr.

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Date

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Alex Trevino, Jr.  
President and  
Chief Executive Officer

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I, Anthony R. Maresca, certify that:

- (1) I have reviewed this quarterly report on Form 10-Q of ACR Group, Inc.;
- (2) Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

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- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
- (6) The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent

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evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

October 15, 2002

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Date

/s/ Anthony R. Maresca

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Anthony R. Maresca  
Senior Vice-President and  
Chief Financial Officer

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