

Edgar Filing: ACR GROUP INC - Form 10-K

ACR GROUP INC
Form 10-K
May 29, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
For Annual Reports Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the Fiscal Year Ended February 28, 2002 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
(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)

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.

The aggregate market value of the common stock held by nonaffiliates of the registrant on April 30, 2002 was \$3,742,363. The aggregate market value was computed by reference to the closing price as reported on the OTC Bulletin Board. For the purposes of this response, Executive

Officers, Directors and holders of more than 10% of the Registrant's common stock are considered affiliates of the registrant.

The number of shares outstanding of the registrant's common stock as of April 30, 2002: 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 2002 is incorporated by reference in answer to

Edgar Filing: ACR GROUP INC - Form 10-K

Part III of this report.

-2-

TABLE OF CONTENTS

	Page

PART I	
Item 1. Business	4
Item 2. Properties	9
Item 3. Legal Proceedings	9
Item 4. Submission of Matters to a Vote of Security Holders	9
PART II	
Item 5. Market for Registrant's Common Equity and Related Stockholder Matters	9
Item 6. Selected Financial Data	10
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	12
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	19
Item 8. Financial Statements and Supplementary Data	20
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	42
PART III	
Item 10. Directors and Executive Officers of the Registrant	42
Item 11. Executive Compensation	42
Item 12. Security Ownership of Certain Beneficial Owners and Management	42
Item 13. Certain Relationships and Related Transactions	42
PART IV	
Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K	43

-3-

PART I

Edgar Filing: ACR GROUP INC - Form 10-K

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 nine additional HVACR distribution companies and now has 46 branch operations in ten 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's interest in the HVACR distribution industry is a direct result of the business experience of its Chairman and President, Alex Trevino, Jr., who has been associated with the industry for over thirty years in varying capacities, first as owner of his own distribution company and then as president of various successor companies following the sale of his business.

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

-4-

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,

Edgar Filing: ACR GROUP INC - Form 10-K

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.

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.

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

ACR Supply, Inc.

The Company acquired ACR Supply, Inc. ("ACRS") in 1993, after making an initial investment in the company in 1991. At the end of fiscal 2002, ACRS had fifteen 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 26% equipment and 74% 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, Inc.

The Company acquired Heating and Cooling Supply, Inc. ("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.

-5-

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 most HVACR distributors, HCS also has capabilities to service both the commercial plan and specifications market and specialty products markets. The company intends to direct greater attention to the HVACR aftermarket in the immediate future in an effort to gain higher margin business.

Edgar Filing: ACR GROUP INC - Form 10-K

Total Supply, Inc.

Total Supply, Inc. ("TSI") has operated as an HVACR wholesale distributor in Georgia since 1992. Since 1993, TSI has distributed the GMC brand of HVACR equipment in Georgia and now has the GMC distribution rights to almost the entire state of Georgia. 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. TSI has four branches located in the Atlanta metropolitan area, one branch in Warner Robins, a suburb of Macon, another in Savannah, Georgia and one in Dothan, Alabama.

Valley Supply, Inc.

In 1994, the Company organized Valley Supply, Inc. ("VSI") as an HVACR distributor in the Memphis, Tennessee trade area, which included southwestern Tennessee, northern Mississippi and western Arkansas. In 1997, the Company assigned to management of TSI the responsibility for VSI's operations, and in 1999, VSI gained the distribution rights for GMC equipment in the Nashville trade area. Approximately 71% of VSI's sales consisted of GMC equipment in fiscal 2002. In fiscal 2001, the Company closed its operation in Memphis, Tennessee to concentrate its efforts on selling GMC equipment in the larger metropolitan areas of central and south central Tennessee.

Ener-Tech Industries, Inc.

In 1996, the Company acquired Ener-Tech Industries, Inc. ("ETI"), an HVACR distributor in Nashville, Tennessee. Unlike the Company's other HVACR distribution operations, ETI specializes in an industry subsegment. ETI sells controls and control systems to commercial and industrial end-users, HVACR contractors, dealers and other distributors. ETI also designs and assembles control systems used in commercial applications such as hospitals, restaurants and supermarkets. Such control systems perform a variety of functions including temperature control and monitoring, lighting control and energy management.

ETI is an authorized distributor for Honeywell, Inc. for much of Tennessee and parts of Kentucky. By providing engineering services and assembly processes for its customers in connection with the sale of control systems, ETI obtains a higher gross margin on its sales than the Company's other distribution businesses. Additionally, ETI's sales tend to be greater in the cooler seasons of the year, when gas controls are in higher demand.

-6-

Florida Cooling Supply, Inc.

In 1996, the Company organized Florida Cooling Supply, Inc. ("FCS") and opened four branch operations in west central Florida. 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 35% equipment and 65% parts and supplies. In fiscal 2000, the operation in Winter Haven, Florida was closed. The customers from this area continued to be serviced from the Company's Lakeland, Florida location. In fiscal 2001, the Company opened branch operations in Gainesville and Jacksonville,

Edgar Filing: ACR GROUP INC - Form 10-K

Florida expanding its sales territory outside the Tampa Bay area of Florida.

Lifetime Filter, Inc.

In 1997, the Company acquired Lifetime Filter, Inc. ("LFI"), a manufacturer of air filters for the HVACR industry. LFI is based in Katy, Texas, a suburb of Houston. At that time, LFI manufactured principally semi-permanent electrostatic air filters that were sold by mail order to contractors and dealers across the country. The market demand for electrostatic filters has diminished since 1997, and the company expects that trend to continue.

Since 1997, in an effort to increase the size of its average sales order, LFI has added to its sales mix certain other HVACR supplies and parts that are suited for mail order delivery. In fiscal 2002, resale of HVACR products represented approximately 8% of LFI's sales.

In 1999, LFI began to manufacture disposable pleated air filters, which have greater filtering capability and a somewhat longer life than the traditional disposable fiberglass air filter. Pleated air filters are projected to have increasing demand in both commercial and residential applications and are more readily sold through the Company's existing wholesale distribution network. In fiscal 2002, sales of its pleated filters represented approximately 46% of LFI's gross sales. LFI is also evaluating opportunities to begin business-to-business sales of a variety of its filter products over the Internet.

West Coast HVAC Supply, Inc. d/b/a ACH Supply

In 1997, West Coast HVAC Supply, Inc. acquired the operating assets and liabilities of ACH Supply, Inc., ("ACH"). ACH had two branches located east of Los Angeles. In fiscal 1999, ACH opened a third branch in Canoga Park. The Company has attracted key employees with significant management experience working for a much larger HVACR wholesale distributor in southern California. ACH sells primarily HVACR parts and supplies, and, late in fiscal 2000, began distributing the Tappan brand of HVACR equipment. In fiscal 2001, the Company opened four new branches: Santa Ana and Redlands in the southern and eastern trade areas surrounding Los Angeles, and in Fresno and Bakersfield, expanding into the central California market areas. These two branches in central California distribute the Comfortmaker line of HVACR equipment.

-7-

Contractors Heating & Supply, Inc. ("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 the market leader 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 18% of CHS's total sales are products that it manufactures. In April 1999, CHS opened a distribution branch in Fort Collins, Colorado, and, in March 2000, acquired International Comfort Supply, Inc., a

Edgar Filing: ACR GROUP INC - Form 10-K

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, and also opened a branch operation and distribution center in east Denver.

Energy Service Business

In the early 1980's, the Company's primary business was the design, installation and management of integrated systems intended to reduce energy costs ("Systems") for users of commercial, industrial and institutional facilities. Pursuant to service contracts, customers paid ACRG a specified percentage of the utility cost savings attributable to the Systems over the term of the contract. In fiscal 2000, the Company reached an understanding with its final energy services customer to terminate services at the end of October 1999, with the customer agreeing to make a contract termination payment to the Company and to pay for all utility cost savings computed through the termination date. This process was completed in April 2000.

Executive Officers of the Registrant

The Company's executive officers are as follows:

Name	Age	Position with the Company
----	---	-----
Alex Trevino, Jr.	65	Chairman of the Board and President
Anthony R. Maresca	51	Senior Vice President, Treasurer, and Chief Financial Officer
A. Stephen Trevino	39	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. From September 1987 to February 1990, he served as President of Western Operations of the Refrigeration and Air Conditioning Group of MLX Corporation (now Pameco Corporation), which is a national distributor of HVACR equipment and supplies.

-8-

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 Vice President and Secretary in August 2000.

Employees

As of February 28, 2002, the Company and its subsidiaries had approximately 450 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.

Edgar Filing: ACR GROUP INC - Form 10-K

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 LFI, the Pasadena, Texas branch of ACRS, and the Gainesville, Florida branch of FCS.

Item 3. Legal Proceedings.

As of February 28, 2002 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 28, 2002.

PART II

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

Until May 2001, the Company's common stock traded on the NASDAQ Stock Market(R) under the symbol "ACRG." The table below sets forth the high and low sales prices based upon actual transactions.

Effective May 9, 2001, the Company's common stock was delisted from the Nasdaq Stock Market for failure to maintain a closing bid price of at least \$1.00 per share. The Company's common stock is now traded in the over-the-counter market under the symbol "ACRG" as before, or by the symbols "ACRG.OB", or "ACRG.BB", depending on the source of the quote.

-9-

	High ----	Low -----
Fiscal Year 2002		
1st quarter ended 5/31/01	\$0.65	\$0.29
2nd quarter ended 8/31/01	0.72	0.50
2nd quarter ended 11/30/01	0.73	0.43
4th quarter ended 2/28/02	0.55	0.24
Fiscal Year 2001		
1st quarter ended 5/31/00	\$2.00	\$1.34
2nd quarter ended 8/31/00	1.64	1.00
3rd quarter ended 11/30/00	1.38	0.56
4th quarter ended 2/28/01	0.81	0.50

As of April 30, 2002, there were 477 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 agreements with two lenders each expressly prohibit 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 4 of Notes to Consolidated Financial Statements.

Edgar Filing: ACR GROUP INC - Form 10-K

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, 1998, the increase in sales has resulted from acquisitions and 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.

The Company has not recorded a provision for income taxes other than federal alternative minimum taxes and state income taxes for fiscal years 1998 through 2002 because of previously incurred net operating losses for which a tax benefit had not previously been recorded. Additionally, the Company determined in fiscal 1998 that a further reduction in its deferred tax asset valuation allowance was appropriate, given expectations of higher future taxable income from recently acquired businesses. As a result, the Company recorded additional tax benefits of \$420,000 in fiscal 1998.

-10-

	(In thousands, except per share)		
	Year Ended February 28 or 29		
	2002	2001	2000
	-----	-----	-----
Income Statement Data			
Sales	\$ 155,490	\$ 136,433	\$ 126,468
Gross profit	33,929	29,452	28,135
Operating income	2,097	772	4,077
	-----	-----	-----
Income (loss) before income taxes	542	(1,341)	2,482
Benefit (provision) for income taxes	(123)	(137)	(255)
	-----	-----	-----
Net income (loss)	\$ 419	\$ (1,478)	\$ 2,227
	=====	=====	=====
Earnings per common share:			
Basic	\$.04	\$ (0.14)	\$.21
	=====	=====	=====
Diluted	\$.04	\$ (0.14)	\$.20
	=====	=====	=====
As of February 28 or 29,			
	-----	-----	-----
	2002	2001	2000
	-----	-----	-----
Balance Sheet Data			
Working capital	\$ 21,400	\$ 21,170	\$ 18,072
Total assets	56,630	54,582	44,842
Long-term obligations	23,728	24,494	17,499

Edgar Filing: ACR GROUP INC - Form 10-K

Shareholders' equity	10,566	10,147	11,630
----------------------	--------	--------	--------

-11-

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

Results of Operations

Net income (loss) was \$418,761, \$(1,477,593) and \$2,226,633 in fiscal 2002, 2001 and 2000, respectively. Results of operations in fiscal 2002 and 2001 were significantly affected by the costs associated with the opening of ten branch operations in fiscal 2001 and the subsequent operating performance of those branches in their first full year of operation. The costs associated with new branch operations were largely anticipated, although delays in obtaining local regulatory approval for certain new facilities caused pre-opening expenses to exceed expectations. Operating losses associated with the new branch operations were \$800,000 in fiscal 2002, compared to \$1.4 million in fiscal 2001. Generally, new branches are not expected to become profitable until 12-18 months after opening, and the Company believes that the relatively poor performance of the HVACR industry in 2000 and 2001 has extended the period of time required for some of the new branches to achieve breakeven sales levels.

Results of operations in fiscal 2001 were also depressed by reduced operating income at the Company's three largest subsidiaries, compared to fiscal 2000. The decline in profitability of these existing operations had not been forecasted and generally mirrored an unexpectedly poor year in the HVACR industry. In fiscal 2002, operating results at such businesses were slightly improved compared to 2001. In addition to improved results from new branch operations, net income in fiscal 2002 was positively affected by both lower interest costs and the elimination of losses incurred at its Memphis, Tennessee branch operation, which was closed in the fourth quarter of fiscal 2001 after several years of substandard operating results. In the fourth quarter of fiscal 2002, the Company closed a branch operation that had been opened in fiscal 2001 to distribute a new brand of HVACR equipment and combined such business into its other Texas operations.

Same-store sales increased 9% in fiscal 2002 after being unchanged in fiscal 2001 and increasing 5% in fiscal 2000. Excluding branches that were opened in fiscal 2001, same-store sales increased 6% in fiscal 2002 over fiscal 2001. By comparison, data compiled by a leading industry trade association indicate that industry-wide product shipments declined 6% in calendar 2001, after increasing 1% and 6% in calendar 2000 and 1999, respectively. In fiscal 2002, over 80% of the Company's branches generated increases in sales over fiscal 2001. Of the Company's major trade markets, only the Colorado market was significantly adversely affected by the downturn in the U.S. economy in 2001. During the last two quarters of fiscal 2002, the Company experienced double-digit sales decreases in the Colorado market as a result of slowing new residential construction. In fiscal 2001, although the Company recorded double-digit same-store sales increases in Florida and California, the gains at these relatively small operations were more than offset by flat or declining sales in Texas, Colorado and Georgia. The slowdown in business was not directly attributable to a single factor, but rather to a complex mix of factors, ranging from unfavorable weather conditions in certain geographic areas to unusually high inventory shrinkage at two Texas branches.

-12-

Edgar Filing: ACR GROUP INC - Form 10-K

The Company's gross margin percentage was 21.8% in fiscal 2002, compared to 21.6% in fiscal 2001 and 22.2% in fiscal 2000. The decrease in gross margin from fiscal 2000 to fiscal 2001 was attributable to both the new branch operations, which in some cases reduced selling prices to gain initial business, and declines in the Texas, Nevada and Tennessee markets. Despite the weakness of the HVACR industry, the Company's gross margin percentage improved slightly in fiscal 2002, as margins at new branch locations increased to levels closer to more established operations.

Selling, general and administrative ("SG&A") costs as a percentage of sales were 20.5% in fiscal 2002, compared to 21.1% in fiscal 2001 and 19.1% in fiscal 2000. The increase in SG&A costs as a percentage of sales in both fiscal 2001 and 2000 was attributable to costs associated with new branch operations and personnel employed to support the Company's internal growth goals. In particular, SG&A costs are incurred at new branch operations before sales are generated and, after a branch is open, remain high as a percentage of sales as sales ramp up to expected levels. In fiscal 2002, the decline in SG&A costs as a percentage of sales resulted from leveraging the SG&A costs of the branch operations opened in fiscal 2001. The emphasis on growth in central and southern California especially impacted SG&A costs in both fiscal 2001 and 2002 as occupancy and other operating costs tend to be significantly higher there compared to the Company's other market areas.

Interest expense decreased 16% in fiscal 2002 compared to fiscal 2001, after an increase of 24% in fiscal 2001 compared to fiscal 2000. The decrease in interest expense in fiscal 2002 resulted from a series of interest rate cuts during 2001. In fiscal 2001, the increase in interest expense was due both to increased average interest rates and to increased borrowings under the Company's revolving credit facility to finance the working capital requirements of the new branches opened in fiscal 2001. In fiscal 2002, 2001 and 2000, interest expense was 1.3%, 1.8% and 1.6% of sales, respectively. Other non-operating income, which consists principally of finance charges to customers, increased 42% from fiscal 2001 to fiscal 2002, after decreasing 10% from fiscal 2000 to fiscal 2001. The increase in non-operating income in fiscal 2002 was a result of heightened credit and collection management in a tighter economy.

Current income tax expense consists principally of state income taxes. As a result of the Company's substantial tax loss carryforwards, the Company has minimal liability for Federal income taxes. See Liquidity and Capital Resources, below.

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.

-13-

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

Edgar Filing: ACR GROUP INC - Form 10-K

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 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 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.

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,

-14-

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 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

Edgar Filing: ACR GROUP INC - Form 10-K

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

Working capital increased from \$21.2 million in fiscal 2001 to \$21.4 million in fiscal 2002, as a result of cash flow from operations. Accounts receivable represented 47 days of gross sales at the end of fiscal 2002 and 49 days at the end of fiscal 2001. The increase in inventory from the end of fiscal 2001 to 2002 is generally located at the branches that were opened in fiscal 2001.

The Company has a loan agreement ("Agreement") with a commercial bank ("Bank") that was amended and restated in May 2000 to increase to \$25 million the amount that may be borrowed by the Company under a revolving credit facility and to provide facilities for the purchase of both real estate and capital assets. The Agreement was further amended in February 2002 to amend certain financial covenants. The Agreement terminates in May 2003, but is automatically extended for one-year periods unless either party gives notice of termination to the other. Prepayment penalties apply if the revolving credit facility is prepaid during the first two years of the term. 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 28, 2002, 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 28, 2002, 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 \$10 million of outstanding borrowings under the facility, and the balance of outstanding borrowings bears interest at a floating rate. At February 28, 2002, the average interest rate on all borrowings under the facility was 6.48%. 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 28, 2002, the Company's available credit under the facility was approximately \$1.2 million.

The Agreement provides a capital expenditure term loan facility of \$1 million for capital assets acquired after March 2000. As of February 28, 2002, the Company had borrowed \$613,000 under the capital expenditure facility. Of such borrowings, \$523,026 was outstanding

-15-

at February 28, 2002, and is repaid in equal monthly principal installments of \$10,216, plus interest. The Agreement also provides for financing the purchase of certain real estate and improvements. At February 28, 2002, the Company had indebtedness to the Bank for real estate loans of \$684,295, 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 \$6,463, 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 28, 2002. At February 28, 2002, the Company also had outstanding borrowings aggregating \$63,063 under a previous term loan arrangement with the Bank for the purchase of capital assets, which was paid in full in March 2002.

Edgar Filing: ACR GROUP INC - Form 10-K

At February 28, 2002, the Company was not in compliance with certain of the required financial ratios contained in its loan agreement with The Catalyst Fund, Ltd. and an affiliate ("Catalyst"). See Note 4 of Notes to Consolidated Financial Statements. Such indebtedness, which aggregated \$429,059 as of February 28, 2002, is payable in full in fiscal 2003, and accordingly, is classified as a current liability in the Company's financial statements as of February 28, 2002. The Company believes that it is unlikely that Catalyst would elect to exercise any of its rights under the loan agreement because of non-compliance with such covenants. However, should Catalyst elect to do so, the Company believes that it would have the capacity under its revolving credit facility with the Bank to pay in full the balance of the notes.

The Company made capital expenditures of \$0.8 million in fiscal 2002, compared to \$3.2 million in fiscal 2001, for building and leasehold improvements, computer hardware and software, and equipment under capital leases. Included in the capital expenditures from fiscal 2001 were the purchase of a building in Gainesville, Florida for a new branch operation of FCS and the construction of a finished goods warehouse at LFI. The real estate purchase in Florida was partially financed by the sellers. The sellers financed \$825,000 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.

The Company has significant commitments for non-cancelable operating leases as of February 28, 2002. The majority of such commitments are 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 28, 2002 are summarized as follows:

-16-

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1-3 Years	4-5 Years	After 5 Years
	(In thousands)				
Long-term debt	\$ 24,348	\$ 785	\$ 22,214	\$ 370	\$ 979
Capital lease obligations	278	113	138	27	-
Operating leases	21,078	4,728	7,410	4,418	4,522
	\$ 45,704	\$ 5,626	\$ 29,762	\$ 4,815	\$ 5,501
	=====	=====	=====	=====	=====

Other Commercial Commitments	Amounts Committed	Expiration Per Period
		Less than 1 year
		(In thousands)

Edgar Filing: ACR GROUP INC - Form 10-K

Consigned inventory	\$ 10,464	\$10,464
	=====	=====

The Company has approximately \$4.7 million in tax loss carryforwards, of which \$3.4 million will expire in fiscal 2003, and the remainder in years after 2003. Such operating loss carryforwards will substantially limit the Company's federal income tax liabilities in fiscal 2003. Certain provisions of the Internal Revenue Code ("Code") regulate the amount of additional stock that the Company could issue without resulting in a change in ownership control, as defined in the Code. Should such a change in control be deemed to occur, the Company's ability to utilize its operating loss carryforwards would be severely restricted.

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 does not presently plan to open new branch operations in fiscal 2003. 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.

-17-

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 June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133, as amended by Statement of Financial Accounting Standard No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FAS Statement No. 133" ("SFAS 137") which is effective for fiscal years beginning after June 15, 2000, requires all derivatives to be recognized at fair value on the balance sheet. The Company adopted SFAS 133 in fiscal year 2002. The change did not have a significant effect on the Company's financial statements.

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"). FAS 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives. FAS 142 requires that these assets be reviewed for impairment at least annually.

Edgar Filing: ACR GROUP INC - Form 10-K

Intangible assets with finite lives will continue to be amortized over their estimated useful lives. The Company will apply FAS 142 beginning in the first fiscal quarter of 2003. Application of the nonamortization provisions of FAS 142 is expected to result in an increase in net income of \$230,000 (\$0.02 per diluted share) in 2003. The Company will test goodwill for impairment using the two-step process prescribed in FAS 142. The first step is a screen for potential impairment, while the second step measures the amount of impairment, if any. The Company expects to perform the first of the required impairment tests of goodwill and indefinite lived intangible assets as of February 28, 2002 in the first fiscal quarter of 2003. Any impairment charge resulting from these transitional impairment tests will be reflected as the cumulative effect of a change in accounting principle in the first fiscal quarter of 2003. The Company has not yet determined what the effect of these tests will be on the earnings and financial position of the Company.

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FAS 144"), which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supercedes FAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of", and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations, for a disposal of a segment or a business". FAS 144 is effective for fiscal years beginning after December 15, 2001, with earlier application encouraged. The Company expects to adopt FAS 144 for the fiscal year ended February 28, 2003 and it does not expect that the adoption of the statement will have a significant impact on the Company's financial position and results of operations.

-18-

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

Edgar Filing: ACR GROUP INC - Form 10-K

certain borrowings based on a spread over LIBOR for 30 days to 6 months. At February 28, 2002 the Company had \$23.0 million outstanding under its senior credit facility, of which \$13.0 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 \$130,000, or \$.01 per basic share, on an annual basis.

-19-

Item 8. Financial Statements and Supplementary Data.

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

	Page

Report of Independent Auditors	21
Consolidated balance sheets as of February 28, 2002 and February 28, 2001	22
Consolidated statements of operations for the fiscal years ended February 28, 2002, February 28, 2001 and February 29, 2000	24
Consolidated statements of shareholders' equity for the fiscal years ended February 28, 2002, February 28, 2001 and February 29, 2000	25
Consolidated statements of cash flows for the fiscal years ended February 28, 2002, February 28, 2001 and February 29, 2000	26
Notes to Consolidated Financial Statements	28

-20-

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 28, 2002 and 2001, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended February 28, 2002. Our audits also

Edgar Filing: ACR GROUP INC - Form 10-K

included the financial statement schedule listed in the index at Item 14(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 28, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the three years in the period ended February 28, 2002, 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 herein.

ERNST & YOUNG LLP

Houston, Texas
May 7, 2002

-21-

ACR GROUP, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

As of February 28, 2002 and 2001

ASSETS

	2002	2001
	-----	-----
Current assets:		
Cash	\$ 128,960	\$ 171,249
Accounts receivable, net of allowance for doubtful accounts of \$843,886 in 2002 and \$670,432 in 2001	16,857,892	15,975,668
Inventory	25,987,092	23,833,400
Prepaid expenses and other	275,058	642,912
Deferred income taxes	487,000	487,000
	-----	-----
Total current assets	43,736,002	41,110,229
	-----	-----

Edgar Filing: ACR GROUP INC - Form 10-K

Property and equipment, net of accumulated depreciation	5,405,177	5,768,093
Deferred income taxes	973,000	973,000
Goodwill, net of accumulated amortization of \$1,130,107 in 2002 and \$897,844 in 2001	5,990,632	6,222,895
Other assets	525,367	507,350
	-----	-----
Total assets	\$56,630,178	\$54,581,567
	=====	=====

-22-

ACR GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

As of February 28, 2002 and 2001

LIABILITIES AND SHAREHOLDERS' EQUITY

	2002	2001
	-----	-----
Current liabilities:		
Current maturities of long-term debt	\$ 784,791	\$ 826,016
Current maturities of capital lease obligations	112,869	130,185
Accounts payable	19,411,193	17,146,529
Accrued expenses and other liabilities	2,026,884	1,837,638
Total current liabilities	22,335,737	19,940,368
	-----	-----
Long-term debt	23,563,173	24,229,774
Long-term capital lease obligations	165,315	264,233
Total liabilities	46,064,225	44,434,375
	-----	-----
Shareholders' equity:		
Preferred stock, \$.01 par, authorized 2,000,000 shares, none outstanding		
Common stock, \$.01 par, authorized 25,000,000 shares, issued and outstanding 10,681,294 shares in 2002 and 2001	106,813	106,813
Additional paid-in capital	41,691,379	41,691,379
Accumulated deficit	(31,232,239)	(31,651,000)
Total shareholders' equity	10,565,953	10,147,192
	-----	-----
Total liabilities and shareholders' equity	\$ 56,630,178	\$ 54,581,567

Edgar Filing: ACR GROUP INC - Form 10-K

=====

The accompanying notes are an integral part
of these financial statements

-23-

ACR GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

For the Fiscal Years Ended February 28, 2002, February 28, 2001 and
February 29, 2000

	2002	2001
	-----	-----
Sales	\$ 155,490,357	\$ 136,433,240
Cost of sales	121,560,865	106,981,285
	-----	-----
Gross profit	33,929,492	29,451,955
Selling, general and administrative expenses	(31,832,059)	(28,726,419)
Energy services income, net	--	46,017
	-----	-----
Operating income	2,097,433	771,553
Interest expense	(2,086,506)	(2,487,606)
Other non-operating income	531,172	374,778
	-----	-----
Income (loss) before income taxes	542,099	(1,341,275)
Provision for income taxes:		
Current	123,338	136,318
	-----	-----
Net income (loss)	\$ 418,761	\$ (1,477,593)
	=====	=====
Earnings (loss) per common share:		
Basic	\$.04	\$ (.14)
	=====	=====
Diluted	\$.04	\$ (.14)
	=====	=====

The accompanying notes are an integral part
of these financial statements

-24-

ACR GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Edgar Filing: ACR GROUP INC - Form 10-K

For the Fiscal Years Ended February 28, 2002, February 28, 2001 and
February 29, 2000

	No. of Shares Issued	Par Value	Additional Paid-In Capital	Accumulat Deficit
	-----	-----	-----	-----
Balance, February 28, 1999	10,659,303	\$ 106,593	\$41,684,697	\$(32,400,0
Exercise of options	11,331	113	(113)	
Issuance of warrant			12,000	
Net income				2,226,6
Balance, February 29, 2000	----- 10,670,634	----- 106,706	----- 41,696,584	----- (30,173,4
Exercise of options	10,660	107	(12,205)	
Issuance of warrant			7,000	
Net loss				(1,477,5
Balance, February 28, 2001	----- 10,681,294	----- 106,813	----- 41,691,379	----- (31,651,0
Net income				418,7
Balance, February 28, 2002	----- =====	----- =====	----- =====	----- =====

The accompanying notes are an integral part
of these financial statements

-25-

ACR GROUP, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Fiscal Years Ended February 28, 2002, February 28, 2001 and
February 29, 2000

	2002	2001
	-----	-----
Operating activities:		
Net income	\$ 418,761	\$(1,477,5
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation	1,133,117	1,033,117
Amortization	299,557	27,000
Issuance of warrants	-	-
Provision for bad debts	703,731	63,000
Loss (gain) on sale of assets	(21,206)	3,000
Changes in operating assets and liabilities:		
Accounts receivable	(1,585,955)	(1,875,000)

Edgar Filing: ACR GROUP INC - Form 10-K

Inventory	(2,153,692)	(5,028)
Prepaid expenses and other assets	238,169	(56,169)
Accounts payable	2,264,664	4,169,664
Accrued expenses and other liabilities	189,246	8,246
Net cash provided by (used in) operating activities	1,486,392	(2,708,392)
Investing activities:		
Acquisition of property and equipment	(765,949)	(2,105,949)
Acquisition of businesses, net of cash acquired	-	(20,000)
Proceeds from disposition of assets	61,328	5,328
Net cash used in investing activities	(704,621)	(2,250,621)
Financing activities:		
Proceeds from long-term debt	887,514	6,625,514
Payments on long-term debt	(1,711,574)	(1,596,574)
Net cash (used in) provided by financing activities	(824,060)	5,038,940
Net (decrease) increase in cash	(42,289)	6,325,240
Cash at beginning of year	171,249	10,650,480
Cash at end of year	\$ 128,960	\$ 17,075,720

(continued)

-26-

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Fiscal Years Ended February 28, 2002, February 28, 2001 and
February 29, 2000
(continued)

	2002	2001
	-----	-----
Schedule of non-cash investing and financing activities		
Acquisition of subsidiaries:		
Fair value of assets acquired	\$ --	\$ 793,712
Fair value of liabilities assumed	--	817,915
Goodwill	--	404,203
Notes payable to sellers	--	152,000
Purchase of property and equipment (net of cash):		
For notes payable	--	825,000
Under capital leases	19,333	271,529
Supplemental cash flow information:		
Interest paid	2,046,515	2,472,050
Federal income taxes paid	10,000	16,477

The accompanying notes are an integral part
of these financial statements

ACR GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 - Description of Business and Summary of Significant Accounting Policies

Description of Business

ACR Group, Inc.'s (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

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 recognizes revenue in accordance with SEC Statement of Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements". The Company's revenues consist of sales of HVACR products. SAB 101 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

Edgar Filing: ACR GROUP INC - Form 10-K

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.

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 \$10,463,828 at February 28, 2002 and \$11,562,340 at February 28, 2001.

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 permitting such inventory to remain on consignment.

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 assets. Substantially all goodwill is being amortized on a straight-line basis over 40 years. The carrying value of goodwill is reviewed if the facts and circumstances suggest that it may be impaired. If this review indicates that goodwill will not be recoverable over the remaining amortization period, as determined based on the undiscounted cash flows of the entity acquired, the Company's carrying value of the goodwill will be reduced by the estimated shortfall of the discounted cash flows.

-29-

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.

Edgar Filing: ACR GROUP INC - Form 10-K

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

The Company measures compensation cost for stock-based compensation plans using the intrinsic value method of accounting.

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 36% of all purchases made in fiscal 2002 and 2001 and 32% of all purchases made in 2000. 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.

Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"). FAS 133, as amended by Statement of Financial Accounting Standard No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FAS Statement No. 133" ("FAS 137") which is effective for fiscal years beginning after June 15, 2000, requires all derivatives to be recognized at fair value on the balance sheet. The Company adopted FAS 133 in fiscal year 2002. The change did not have a significant effect on the Company's financial statements.

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"). FAS 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives. FAS 142 requires that these assets be reviewed for impairment at least annually. Intangible assets with finite lives will continue to be amortized over their estimated useful lives. The Company will apply FAS 142 beginning in the first fiscal quarter of 2003. Application of the nonamortization provisions of FAS 142 is expected to result in an increase in net income of \$230,000 (\$0.02 per diluted share) in 2003. The Company will test goodwill for impairment using the two-step process prescribed in FAS 142. The first step is a screen for potential impairment, while the second step measures the amount of impairment, if any. The Company expects to perform the first of the required impairment tests of goodwill and

-30-

indefinite lived intangible assets as of February 28, 2002 in the first fiscal quarter of 2003. Any impairment charge resulting from these transitional impairment tests will be reflected as the cumulative effect of a change in accounting principle in the first fiscal quarter of 2003. The Company has not yet determined what the effect of these tests will be on the earnings and financial position of the Company.

Edgar Filing: ACR GROUP INC - Form 10-K

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FAS 144"), which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supercedes FAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of", and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations, for a disposal of a segment or a business". FAS 144 is effective for fiscal years beginning after December 15, 2001, with earlier application encouraged. The Company expects to adopt FAS 144 for the fiscal year ended February 28, 2003 and it does not expect that the adoption of the statement will have a significant impact on the Company's financial position and results of operations.

2 - Acquisitions

In March 2000, the Company, through a wholly owned subsidiary, entered into a Purchase Agreement pursuant to which it acquired all of the issued and outstanding capital stock of International Comfort Supply, Inc., a Texas corporation for \$380,000. As consideration for the acquisition, the Company paid \$228,000 cash and issued a promissory note for \$152,000. The note is due and payable in 6 equal semi-annual installments of principal and interest commencing September 1, 2000. The excess of the final purchase price over the estimated fair value of the net assets acquired was \$404,203, which was recorded as goodwill, and is being amortized on a straight-line basis over 40 years. Pro forma results of operations relating to this acquisition are not presented because the effects of the acquisition would not be considered material.

The acquisition described above was accounted for using the purchase method of accounting, and the consolidated financial statements include the operating results from the respective dates of acquisition.

3 - Property and Equipment

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

	2002	2001
	-----	-----
Land	\$ 311,046	\$ 309,693
Building and leasehold improvements	3,602,070	3,517,616
Furniture and fixtures	237,730	230,067
Vehicles	1,240,344	1,364,892
Other equipment	5,055,734	4,615,316
	-----	-----
	10,446,924	10,037,584
Less accumulated depreciation	(5,041,747)	(4,269,491)
	-----	-----
Net property and equipment	\$ 5,405,177	\$ 5,768,093
	=====	=====

Capitalized lease assets of \$565,684 and \$785,755 together with accumulated amortization of \$183,960 and \$265,850 are included in property and equipment as of February 28, 2002 and 2001. Amortization expense is included with depreciation expense.

4 - Debt

Edgar Filing: ACR GROUP INC - Form 10-K

Debt is summarized as follows at the end of February:

	2002	2001
	-----	-----
Revolving line of credit	\$21,724,133	\$22,585,856
Real estate loan	684,295	266,220
Equipment term loan	586,089	157,659
Notes payable - Catalyst Fund and affiliate	429,059	891,559
Note payable to sellers of real property	797,545	815,299
Notes payable to sellers of companies acquired (note 2)	76,000	263,380
Other	50,843	75,817
	-----	-----
	24,347,964	25,055,790
Less current maturities	(784,791)	(826,016)
	-----	-----
Long-term debt, less current maturities	\$23,563,173	\$24,229,774
	=====	=====

-32-

The Company has a loan agreement ("Agreement") with a commercial bank ("Bank") that was amended and restated in May 2000 to increase to \$25 million the amount that may be borrowed by the Company under a revolving credit facility and to provide facilities for the purchase of both real estate and capital assets. The Agreement was further amended in February 2002 to modify certain financial covenants. The Agreement terminates in May 2003, but is automatically extended for one-year periods unless either party gives notice of termination to the other. Prepayment penalties apply if the revolving credit facility is prepaid prior to June 2002. 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 28, 2002, 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 28, 2002, 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 \$10 million of outstanding borrowings under the facility, and the balance of outstanding borrowings bears interest at a floating rate. At February 28, 2002, the average interest rate on all borrowings under the facility was 6.48%. 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 28, 2002, the Company's available credit under the facility was approximately \$1.2 million.

The Agreement provides a capital expenditure term loan facility of \$1 million for capital assets acquired after March 2000. As of February 28, 2002, the Company had borrowed \$613,000 under the capital expenditure facility. Of such borrowings, \$523,026 was outstanding at February 28, 2002, and is repaid in equal monthly principal installments of \$10,216, plus interest. The Agreement

Edgar Filing: ACR GROUP INC - Form 10-K

also provides for financing the purchase of certain real estate and improvements. At February 28, 2002, the Company had indebtedness to the Bank for real estate loans of \$684,295, 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 \$6,463, 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 28, 2002. At February 28, 2002, the Company also had outstanding borrowings aggregating \$63,063 under a previous term loan arrangement with the Bank for the purchase of capital assets, which was paid in full in March 2002.

In fiscal 1998, the Company obtained loans aggregating \$1.54 million from The Catalyst Fund, Ltd. ("Catalyst") and an affiliate of Catalyst to pay certain outstanding indebtedness to St. James Capital Partners, L.P. ("St. James"), and also borrowed \$450,000 from Catalyst for an acquisition. The Company previously borrowed \$1 million from Catalyst in 1993. Such borrowings bear interest at 12 1/2% per annum, payable monthly. The aggregate outstanding principal at February 28, 2002 is to be repaid in monthly installments of \$30,000 through December 2002, and the remaining unpaid balance in January 2003. The Catalyst loans are all

-33-

secured by the stock and operating assets of certain of the Company's subsidiaries and an assignment of proceeds from life insurance policies on the Company's President. Catalyst has subordinated its security interests to the Bank. In connection with the January 1998 loans, the Company granted Catalyst a warrant to purchase 175,000 shares of the Company's common stock at a price of \$2.06 per share, exercisable at any time before February 28, 2003. In March 2002, the exercise price of such warrants was reduced to \$0.59 per share in connection with Catalyst's waiver of certain debt covenant violations. The proceeds of the January 1998 loans were allocated between the debt and the warrant, resulting in a debt discount of \$50,000, which is being amortized to expense over the term of the loan. In connection with the 1993 loan, the Company granted Catalyst a warrant to purchase 1,000,000 shares of the Company's common stock at a price of \$0.59 per share and, in connection with the amendment to the repayment schedule of the 1993 loan during fiscal 1998, the expiration date of the warrant was extended until February 28, 2003 (see Note 7). Covenants of the Company's loan agreement with Catalyst, which covers all of the Catalyst loans, prohibit dividends and restrict additional borrowings without Catalyst's consent, and also require the Company to maintain specified financial ratios. As of February 28, 2002, the Company was not in compliance with certain of the required financial ratios. The Company believes that it is unlikely that Catalyst would elect to exercise any of its rights under the loan agreement because of non-compliance with such covenants. However, should Catalyst elect to do so, the Company believes that it would have the capacity under its revolving credit facility with the Bank to pay in full the balance of the notes.

In August 2000, the Company purchased real estate in Gainesville, Florida to be occupied as a branch operation for approximately \$957,000. Of the purchase price, the sellers financed \$825,000 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.

The notes payable to sellers include debt incurred in connection with three acquisitions from fiscal 1996 to fiscal 1999 and are payable in installments over terms of three to five years. The seller notes payable at February 28, 2002 bear interest at 10% per annum, and are unsecured and subordinated to the Company's indebtedness to the Bank.

Based upon the borrowing rates currently available to the Company for debt

Edgar Filing: ACR GROUP INC - Form 10-K

instruments with similar terms and average maturities, the carrying value of long-term debt approximates fair value.

Future maturities of debt are \$784,791 in 2003, \$21,980,303 in 2004, \$233,598 in 2005, \$232,550 in 2006, \$137,001 in 2007, and \$979,721 after 2007.

5 - Lease Commitments

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

-34-

Year ending February 28 or 29,	Capital lease payments
2003	\$ 134,375
2004	90,880
2005	58,230
2006	23,885
2007	2,597
Total minimum lease payments	309,967
Less amounts representing interest	(31,783)
Present value of future minimum lease payments	278,184
Less current maturities of capital lease obligations	(112,869)
Long-term obligations under capital leases	\$ 165,315

Additionally, the Company leases its corporate offices, office and warehouse space occupied by its HVACR operations and office equipment and 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 \$4,727,439 in 2003, \$4,108,540 in 2004, \$3,301,140 in 2005, \$2,546,225 in 2006, \$1,871,998 in 2007 and \$4,522,318 after 2007.

Rental expenses were \$4,667,639, \$4,093,554 and \$3,012,236 in 2002, 2001 and 2000, respectively.

6 - Income Taxes

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:

-35-

Year Ended February 28 or 29,

Edgar Filing: ACR GROUP INC - Form 10-K

	2002	2001	2000
	-----	-----	-----
Tax at statutory rate	\$ 184,314	\$ (456,034)	\$ 843,745
Increase (reduction) in tax expense resulting from:			
Change in valuation allowance	804,296	7,608,209	(1,558,282)
Nondeductible expenses	95,462	87,603	80,531
State income taxes	107,280	143,270	202,971
Expired tax credits and expired NOL carryforwards	(1,068,014)	(7,246,730)	686,006
	-----	-----	-----
Actual income tax provision	\$ 123,338	\$ 136,318	\$ 254,971
	=====	=====	=====

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, net of tax, consist of the following as of February 28, 2002:

Deferred Tax Assets:	Current	Long-Term
	-----	-----
NOL Carryforwards	-	\$ 1,599,900
Section 263A capitalization	\$ 389,222	-
Allowance for doubtful accounts	286,921	-
Alternative minimum tax credit	-	165,168
Accrued vacation	150,385	-
Fixed Assets	-	108,697
Other accrued deferred assets	47,371	-
	-----	-----
Total Deferred Tax Assets	\$ 873,899	\$ 1,873,765
Deferred Tax Liabilities:		
Goodwill Amortization	325,449	-
Other accrued deferred liabilities	1,323	-
	-----	-----
Total Deferred Tax Liabilities	326,772	-
Total Temporary Difference	\$ 547,127	\$ 1,873,765
Valuation Allowance	(60,127)	(900,765)
	-----	-----
Net Deferred Tax Assets	\$ 487,000	\$ 973,000
	=====	=====

-36-

As of February 28, 2002, the Company had net operating loss carryforwards of \$4.7 million, which are available to offset future taxable income. \$3.4 million of the carryforwards will expire by 2003 with the remaining carryforwards expiring in fiscal 2007 through fiscal 2016. For financial reporting purposes, the Company has recognized a valuation allowance of \$961,000 as of February 28, 2002 to offset the deferred tax assets related primarily to the loss carryforward and the credit carryforwards. The change in the valuation allowance is primarily due to the use and expiration of net operating loss carryforwards.

7 - Stock Option Agreements and Equity Transactions

Edgar Filing: ACR GROUP INC - Form 10-K

Effective March 1, 1998, both the President and the Chief Financial Officer of the Company entered into employment contracts that expire February 28, 2004 and in connection therewith, were granted options to purchase 300,000 and 100,000 shares of the Company's common stock ("Stock"), respectively, at \$2.24 per share. Such options vest on March 1, 2006. The option agreements further provide for accelerated vesting if the market price of Stock, as defined in the agreements, reaches specified levels prior to the stated vesting date. During fiscal 2000 and 2001, the President acquired Stock through the cashless exercise of options that had been granted under a previous employment agreement by redeeming mature shares. In fiscal 2000, he exercised 25,000 options at \$0.76 per share, resulting in the net issuance of 11,331 shares of Stock, and in fiscal 2001, he exercised 25,000 options at \$0.77 per share, resulting in the net issuance of 10,660 shares of Stock.

In connection with its financing provided to the Company, St. James received a warrant to acquire 280,000 shares of the Company's common stock at an exercise price of \$1.625 per share. The warrant expired unexercised in January 2002. In connection with its loan to the Company, Catalyst received a warrant to purchase 1,000,000 shares of the Company's common stock at a price of \$.59 per share, exercisable at any time before February 2003. See Note 4. In connection with a January 1998 loan to the Company, Catalyst and an affiliate received warrants to purchase an aggregate of 175,000 shares of the Company's common stock at a price of \$2.06 per share, which was subsequently reduced to \$0.59 per share, exercisable at any time before February 2003 (see Note 4). Certain of these warrants outstanding, pursuant to which 1,175,000 shares of common stock may be acquired, contain a put option under certain limited circumstances. The features enabling the holder to exercise the put option are either within management's control or, at the Company's option, provide for a net cash or net share (non-redeemable preferred shares with a defined coupon rate) settlement.

In fiscal 1997, the Company established the 1996 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. 70,000 shares of common stock were available for future grants at February 28, 2002. Options granted under the plan are vested ratably over three years.

-37-

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

	Year Ended February 28 or 29,				
	2002		2001		
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Opt
Outstanding - beginning of year	941,000	\$ 1.92	767,500	\$ 2.09	655
Granted	-	-	255,500	1.12	161
Exercised	-	-	(40,000)	.74	(25)
Forfeited	(36,000)	1.53	(42,000)	1.31	(24)
Outstanding - end of year	905,000	1.94	941,000	1.92	767

Edgar Filing: ACR GROUP INC - Form 10-K

Exercisable - end of year	322,667	1.98	225,500	2.33	199
Weighted average fair value of options granted during year	-		\$ 0.68		\$

905,000 options outstanding at February 28, 2002 have a weighted average exercise price of \$1.94 per share with ranges from \$1.12 to \$2.81 per share. These options have a weighted average contractual life remaining of 1.6 years.

Pro forma information has been determined as if the Company had accounted for its employee stock options under the fair value method of SFAS No. 123. The fair value of these options was estimated at the date of grant using a Black-Scholes option pricing model. For options granted during fiscal 2001, 2000 and 1998, the following assumptions were used:

- Expected life of 5 to 8 years
- No expected dividend yield
- 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

The Company's pro forma information follows:

-38-

	Year Ended February 28 or 29,		
	2002	2001	2000
Pro forma net income	\$262,901	\$(1,634,122)	\$2,081,672
Pro forma basic earnings per share	\$ 0.02	\$ (0.15)	\$ 0.20
Pro forma diluted earnings per share	\$ 0.02	\$ (0.15)	\$ 0.18

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, these models require the input of highly subjective assumptions including the expected stock price volatility. Because of these inherent assumptions, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's employee stock options. As a result of the above factors, possible future grants and the vesting provisions of the Company's stock options, the pro forma results would not necessarily be representative of the effects on reported net income for future years.

8 - 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 \$257,845, \$226,798 and \$198,784 for fiscal 2002, 2001 and 2000, respectively.

9 - Earnings per Share

The numerator used in the calculations of both basic and diluted earnings

Edgar Filing: ACR GROUP INC - Form 10-K

per share for all periods presented was net income. The denominator for each period presented was determined as follows:

-39-

	Year Ended February 28 or 29,	
	2002	2001
Denominator:		
Denominator for basic earnings per share - weighted average shares	10,681,294	10,676,198
Effect of dilutive securities:		
Employee stock options	--	16,260
Warrants	5,377	407,909
Dilutive potential common shares	5,377	424,169
Denominator for diluted earnings per share - adjusted weighted average shares and assumed conversions	10,686,671	11,100,367

At the end of the second quarter of fiscal 2002, there were warrants totaling 1,175,000 shares with an exercise price of \$0.59 per share that were dilutive. Using the treasury stock method in computing the common stock equivalents, these warrants, if exercised, would create 21,506 additional shares for the year, or 5,377 for the quarter.

10 - Quarterly Results (Unaudited)

-40-

In thousands of dollars
(except per share amounts)

	Quarter		
	First	Second	Third
Fiscal Year Ended February 28, 2002			
Sales	\$ 39,709	\$ 46,509	\$ 37,007
Gross Profit	8,602	9,920	7,981
Net Income	396	1,044	(336)
Earnings Per Common Share:			
Basic	.04	.10	(.03)
Diluted	.04	.10	(.03)
Fiscal Year Ended February 28, 2001			
Sales	\$ 33,178	\$ 40,209	\$ 33,650

Edgar Filing: ACR GROUP INC - Form 10-K

Gross Profit	7,115	8,633	7,171
Net Income	200	886	(767)
Earnings Per Common Share:			
Basic	.02	.08	(.07)
Diluted	.02	.08	(.07)

-41-

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.

-42-

PART IV

Item 14. 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 14.

The following financial statement schedule for the years ended February 28, 2002 and 2001 and February 29, 2000 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

Edgar Filing: ACR GROUP INC - Form 10-K

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, 1997 (referred to as "1997 10-K"), or (d) Annual Report on Form 10-K for fiscal year ended February 28, 1998 (referred to as "1998 10-K"), or (e) Annual Report on Form 10-K for fiscal year ended February 29, 2000 (referred to as "2000 Form 10-K"), or (f) Annual Report on Form 10-K for fiscal year ended February 28, 2001 (referred to as "2001 Form 10-K").

-43-

Exhibit Number -----	Description -----
* 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)
*10.3	Employment Agreement between the Company and Anthony R. Maresca dated as of March 1, 1998 (Exhibit 10.3 to 1998 10-K)
*10.4	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)

Edgar Filing: ACR GROUP INC - Form 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)

-44-

*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.

*10.16 Purchase Agreement by and among the Company, Richard O'Leary, Lifetime Filter, Inc. and O'Leary Family Partnership, Ltd. (Exhibit 2.1 to Form 8-K dated January 24, 1997)

*10.17 1996 Stock Option Plan of ACR Group, Inc. (Exhibit 4 to RS 333-16325)

*10.18 Agreement of Purchase and Sale by and between the Company and St. James Capital Partners, L.P. dated as of January 24, 1997 (Exhibit 10.15 to 1997 10-K)

*10.19 10% Convertible Promissory Note of the Company issued to St. James Capital Partners, L.P. dated as of January 24, 1997 (Exhibit 10.16 to 1997 10-K)

-45-

*10.20 Warrant to Purchase 280,000 Shares of Common Stock of the Company issued to St. James Capital Partners, L.P. dated January 24, 1997 (Exhibit 10.17 to 1997 10-K)

Edgar Filing: ACR GROUP INC - Form 10-K

- *10.21 Registration Rights Agreement between St. James Capital Partners, L.P. and the Company dated as of January 24, 1997 (Exhibit 10.18 to 1997 10-K)
- 21.1 Subsidiaries of the Registrant
- 23.1 Consent of Independent Auditors

(b) Reports on Form 8-K

A report on Form 8-K dated February 15, 2002 was filed to report an amendment of the loan agreement with the Company's senior lender revising certain financial covenants and waiving all prior events of default that existed as a result of the Company's non-compliance with certain financial covenants as of August 31, 2001.

(c) Exhibits

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

-46-

SCHEDULE II

ACR GROUP, INC. AND SUBSIDIARIES VALUATION AND QUALIFYING ACCOUNTS

For the Fiscal Years Ended February 28, 2002 and 2001 and February 29, 2000

Description	Balance at beginning of period	Additions Charged to costs and expenses	Charged to other accounts
Year ended February 28, 2002:			
Allowance for doubtful accounts:			
Accounts receivable	\$670,432	\$703,731	\$ -
Year ended February 28, 2001:			
Allowance for doubtful accounts:			
Accounts receivable	\$532,300	\$637,470	\$ -
Year ended February 29, 2000:			
Allowance for doubtful accounts:			
Accounts receivable	\$684,487	\$568,465	\$ -

(1) Accounts/notes and related allowance written off.

-47-

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Edgar Filing: ACR GROUP INC - Form 10-K

ACR GROUP, INC.

Date: May 29, 2002

By: /s/ Anthony R. Maresca

Anthony R. Maresca
Senior Vice President and
Chief Financial Officer

Pursuant to the requirement of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature

/s/ Alex Trevino, Jr. ----- Alex Trevino, Jr.	Chairman of the Board, President and Chief Executive Officer (Principal executive officer)	May 29, 2002
---	---	--------------

/s/ Anthony R. Maresca ----- Anthony R. Maresca	Senior Vice President, Chief Financial Officer and Director (Principal financial and accounting officer)	May 29, 2002
---	--	--------------

/s/ Alan Feinsilver ----- Alan Feinsilver	Director	May 29, 2002
---	----------	--------------

/s/ Roland H. St. Cyr ----- Roland H. St. Cyr	Director	May 29, 2002
---	----------	--------------

/s/ A. Stephen Trevino ----- A. Stephen Trevino	Vice President, General Counsel	May 29, 2002
---	------------------------------------	--------------

-48-

EXHIBIT INDEX

Exhibit Number -----	Description -----
*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)

Edgar Filing: ACR GROUP INC - Form 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)
- *10.3 Employment Agreement between the Company and Anthony R. Maresca dated as of March 1, 1998 (Exhibit 10.3 to 1998 10-K)
- *10.4 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)

Edgar Filing: ACR GROUP INC - Form 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.
- *10.16 Purchase Agreement by and among the Company, Richard O'Leary, Lifetime Filter, Inc. and O'Leary Family Partnership, Ltd. (Exhibit 2.1 to Form 8-K dated January 24, 1997)
- *10.17 1996 Stock Option Plan of ACR Group, Inc. (Exhibit 4 to RS 333-16325)
- *10.18 Agreement of Purchase and Sale by and between the Company and St. James Capital Partners, L.P. dated as of January 24, 1997 (Exhibit 10.15 to 1997 10-K)
- *10.19 10% Convertible Promissory Note of the Company issued to St. James Capital Partners, L.P. dated as of January 24, 1997 (Exhibit 10.16 to 1997 10-K)
- *10.20 Warrant to Purchase 280,000 Shares of Common Stock of the Company issued to St. James Capital Partners, L.P. dated January 24, 1997 (Exhibit 10.17 to 1997 10-K)
- *10.21 Registration Rights Agreement between St. James Capital Partners, L.P. and the Company dated as of January 24, 1997 (Exhibit 10.18 to 1997 10-K)
- 21.1 Subsidiaries of the Registrant
- 23.1 Consent of Independent Auditors