ACR GROUP INC
Form 10-K/A
May 30, 2007

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

FORM 10-K/A

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

For the Fiscal Year Ended February 28, 2007

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

Title of Each Class	**Name of Each Exchange on which Registered**
Common Stock, par value $.01 per share	**American Stock Exchange**

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for any 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 x No ¨

Indicate by check mark if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-K

contained in this form, and no disclosure will 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. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in the Exchange Act Rule 12b-2) Yes ¨ No x

The aggregate market value of the voting stock (common stock) held by non-affiliates of the registrant as of August 31, 2006, the last business day of the registrant's most recently completed second quarter was $50,425,151 based on the closing sale price on that date. For purposes of determining this number all executive officers and directors of the registrant as of August 31, 2006 are considered to be affiliates of the registrant. This number is provided only for purposes of the report on Form 10-K and does not represent an admission by either the registrant or any such person as to the status of such person.

The number of shares outstanding of the registrant's common stock as of April 30, 2007: 12,063,765 shares.

DOCUMENTS INCORPORATED BY REFERENCE

The registrant's definitive Proxy Statement for its Annual Meeting of Shareholders to be held in August 2007 is incorporated by reference in answer to Part III of this report.

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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A ("Amendment No.1") hereby amends our Annual Report on Form 10-K for the fiscal year ended February 28, 2007, which ACR Group, Inc. (the "Company") previously filed with the Securities and Exchange Commission on May 29, 2007 ("Original Filing"). We are filing this Amendment No. 1 to correct (a) the format of certain tables in order to present the information in such tables in a more easily readable manner, and (b) the number of shares of the Company's common stock outstanding as of April 30, 2007, as disclosed on the cover page. Except as described above, no other portion of the Original Filing is being amended or supplemented. The Original Filing continues to speak as of the date of the Original Filing, and we have not updated the disclosure contained therein to reflect any events which occurred at a date subsequent to the date of the Original Filing.

PART I

Item 1. ***Business*****.**

General

ACR Group, Inc. (which, together with its subsidiaries is herein referred to as the "Company", we, us or our) 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 ("HVAC") equipment and supplies. The Company acquired its first operating company in 1990. Since 1990, we have grown through acquisitions and organic start-ups to 54 branch operations located in predominantly Sunbelt states. We are now among the largest independently owned HVAC distribution companies in the United States. All of our operations are in the same line of business. 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 HVAC Distribution Industry

Our description of the HVAC industry relates mainly to central air-conditioning and heating systems that are used in residential and light commercial applications. Large commercial buildings usually have specialized climate control requirements that are met directly by manufacturers without the involvement of distributors. However, distributors acting as an intermediary between manufacturers and the contractors or end users that install or service the HVAC systems generally serve the residential and light commercial HVAC markets in the United States. There are over 1,000 wholesale distributors of HVAC products in the United States. It is a fragmented industry, with the largest distributor having approximately a 7% share of a market estimated at between $25 and $30 billion.

There are many manufacturers of products used in the HVAC industry, and no single manufacturer dominates the market for a range of products. The manufacturers of central HVAC equipment sell their products under multiple brand names and generally limit the number and territory of wholesalers that may distribute their brands, but exclusivity is rare. Many manufacturers of HVAC parts and supplies 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 HVAC products to distributors results in significant competition. The industry traditionally has been characterized by closely-held businesses with operations limited to local or regional geographic areas; however, there is a gradual process of consolidation in the HVAC distribution industry, as many of these companies reach maturity and face strategic business issues such as ownership succession, changing markets and lack of capital to finance growth.

The commercial and residential segments of the HVAC industry are further divided into two markets—new construction sales and replacement and/or repair sales. Some distributors choose to specialize in serving the new construction markets while others focus on the repair/replacement market, commonly referred to as the "aftermarket." Although

homebuilding represents an important component of HVAC distribution sales, the aftermarket is generally estimated to comprise approximately a 70% share of industry revenues. The aftermarket increases in size continuously, as new residential installations add to the installed base of HVAC systems. The mechanical life of central HVAC equipment varies significantly by geographic area due to usage and extent of maintenance. Many consumers replace HVAC units before the end of their useful life because of the availability of more energy efficient models and a desire to ensure operating reliability of their HVAC system.

Our Position in the HVAC Industry

We are among the largest independent distributors in the HVAC industry. We are one of only three independent HVAC distributors whose stock is publicly traded, so it is difficult to easily obtain reliable financial information about our competitors. Some of the HVAC equipment manufacturers own all or a portion of their distribution networks but they do not disclose separate financial information about their distribution operations. Trade associations for the HVAC and related distribution industries publish rankings based on information voluntarily supplied by their members and estimates derived by researchers. Such rankings place us among the top fifteen HVAC distributors in the U.S.

Our Growth Strategy

Since entering the industry with our first acquisition in 1990, we have focused on building the Company through both acquisitions and organic growth. We have concentrated on business development in the Sunbelt states because of the need for air conditioning in that area of the country and because of the higher rate of population growth in southern and western states than in other areas of the country. Although we have made ten acquisitions, we do not consider ourselves to be a “consolidator”.

Rather, we have frequently engaged in a "buy and build" strategy, where we have acquired a small company to gain a presence in a certain market and subsequently built the company through organic growth. We encourage management of our business units to continually seek opportunities to open additional branch operations. Our experience is that most new branches will generate above average revenue growth during their first five years, so we try to maintain a pipeline of planned new branches to help sustain a growth rate higher than average for our industry. Our decentralized business philosophy is also attractive to many experienced managers in our industry, and we have successfully attracted many of our key personnel from competitors.

At the end of April 2007, our operations were in Texas (16 branches), Florida (11 branches), California (9 branches), Georgia (6 branches), Colorado (4 branches), Arizona (3 branches), New Mexico (2 branches), and one branch in Louisiana, Nevada, and Tennessee. We do not have a dedicated business development staff; instead, we rely on our reputation in the industry and on referrals from our industry relationships to alert us to business opportunities. As our industry is comprised mainly of family-owned businesses, our 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.

Our Operating Philosophy

We support a decentralized operating culture where branch managers are responsible for all decisions that affect customer service. Each of our business units has an administrative office that is responsible for coordinating branch activities and performing accounting and clerical functions. Branch managers are responsible, within limitations, for all the operations of their stores, including ordering inventory, order fulfillment and customer pricing. Branch managers have the capability and responsibility to take care of their customers' needs. Branch managers receive monthly operating income statements and have significant financial incentives to develop and manage profitable operations.

Our organizational structure is relatively flat. Branch employees, including outside salespersons, generally report to the branch manager. The branch managers and the administrative office personnel report to the business unit president. Business unit presidents report to the corporate office. We do not have a mid-level management structure, although we occasionally employ product specialists for our HVAC equipment brands.

We currently have eleven employees in our corporate office who perform the duties associated with publicly traded companies and provide functional support to our business units. These duties include investor relations, external financial reporting, treasury management, risk management, information technology support, human resources and payroll.

All of our operations use the same enterprise resource planning (ERP) software and central computer system. We believe this feature is essential to enable us to obtain consistent financial information, maintain an appropriate control structure and regularly monitor our operations with a relatively small corporate office staff.

Our Business Model

Our branch operations are organized into business units that are generally assembled by geographic proximity. A president manages the operations of each business unit. We presently have five business units, which have from seven to sixteen branches. With 54 branches for most of fiscal 2007, our revenues average over $4 million per branch, which is significantly in excess of the average for our industry. We believe that large branches are more easily successful within our decentralized operating structure. Although we have smaller branches that are profitable, we do not open new branches unless we believe they have the potential to generate annual sales of at least $3 million at maturity.

In all respects other than their geographic locations, our business units are sufficiently similar that we consider them to be a single business segment for financial reporting purposes. This determination is based on a review of the aggregation criteria set out in Statement of Financial Accounting Standards ("SFAS") No. 131, Disclosures about Segments of an Enterprise and Related Information, including:

- 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

Description of our Business

We are a key link in the HVAC industry supply chain between manufacturers and contractors and other technically trained end-users. We do not manufacture any products and we do not perform any service on HVAC systems. To sustain our position in the supply chain, we focus on providing value to both our suppliers and our customers. For our suppliers, we maintain a stocking inventory of their products in our physical locations, market their products to local contractors and users through an outside sales force, handle product returns and process warranties. For our customers, we try to be a "one-stop shop" where they can obtain all the products needed for their work. All of our stores have a sales counter where customers can purchase products. We also provide trade credit to our customers, deliver to their places of business or job sites and offer technical training and advice.

Our principal customers are the dealers and contractors who install and service residential and light commercial HVAC systems. We also sell to commercial and institutional end-users that employ HVAC service technicians. We estimate that approximately 80% of our business is for residential applications. Although some HVAC distributors also sell products used by contractors who install and service commercial refrigeration equipment, that industry segment represents an insignificant percentage of our business.

Our customers include both those whose principal business is to install HVAC systems in new construction and those who principally repair, service and replace systems already installed. We have no way to precisely measure the sales volume to each of these industry segments, but we believe that our sales mix approximates that of the entire industry, which is estimated to be 30% for new construction and 70% for the service and replacement aftermarket.

Maintenance of a large and diverse inventory base is an important element in our sales. We regularly purchase inventory from over 400 suppliers. Approximately 34% of our revenues are from sales of HVAC equipment; the remaining 66% of our sales is from installation supplies and service parts. Our principal suppliers of HVAC equipment are International Comfort Products (ICP), a subsidiary of Carrier Corporation, and Haier USA (Haier), which imports consumer products manufactured in China. All of our business units sell equipment brands manufactured by ICP and Haier. Prior to fiscal 2006, two of the Company's business units primarily sold equipment supplied by Goodman Manufacturing (Goodman)

Executive Officers of the Registrant

The Company's executive officers are as follows:

Name	Age	Position with the Company
Alex Trevino, Jr.	70	Chairman of the Board and President
Anthony R. Maresca	56	Senior Vice President, Treasurer and Chief Financial Officer
A. Stephen Trevino	44	Senior Vice President, Secretary and General Counsel

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

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

A. Stephen Trevino has been employed by the Company since March 1999, initially serving as General Counsel and directing various administrative functions. He was elected Senior Vice President and Secretary in August 2000. In August 2005, he was also appointed president of one of the Company's business units.

Employees

As of February 28, 2007, the Company and its subsidiaries had approximately 483 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.

Government Regulations, Environmental and Health and Safety Matters

The HVAC industry and the Company are subject to federal, state and local laws and regulations relating to the generation, storage, handling, emission, transportation and discharge of materials into the environment. These include laws and regulations implementing the Clean Air Act, relating to minimum energy efficiency standards of HVAC systems and the production, servicing and disposal of certain ozone-depleting refrigerants used in such systems, including those established at the Montreal Protocol in 1992 concerning the phase-out of CFC-based refrigerants. The Company's operations are also subject to health and safety requirements including the Occupational, Safety and Health Act (OSHA). The Company is also subject to regulations concerning the transport of hazardous materials, including regulations adopted pursuant to the Motor Carrier Safety Act of 1990. The Company believes that its business is operated in substantial compliance with all applicable federal, state and local provisions relating to the protection of the environment, transport of hazardous materials and health and safety requirements.

The HVAC industry and the Company were also subject to a Department of Energy mandate that required, effective January 23, 2006, that HVAC equipment suppliers manufacture products with a higher standard of energy efficiency. Prior to January 23, 2006, the minimum standard for energy efficiency as measured by industry guidelines was 10 SEER (seasonal energy efficiency rating, the value used to measure energy efficiency). On the effective date, the new standard increased the minimum allowed efficiency to 13 SEER. The transition of products to 13 SEER took place during 2006. The new standard does not prohibit the sale or installation of products below 13 SEER that were manufactured before January 2006, and there are certain market niches where demand for lower efficiency HVAC equipment will continue so long as there is product availability.

Website Access to Company Reports

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

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

Item 1A. *Risk Factors*.

Business Risk Factors

Supplier Concentration

The Company maintains distribution agreements with its key equipment suppliers. Some of the distribution agreements contain provisions that restrict or limit the sale of competitive products in the markets served. Other than the markets where such restrictions and limitations may apply, we may distribute other manufacturers' lines of air conditioning or heating equipment. Purchases from a key supplier comprised 33% of all purchases made in fiscal 2007. Any significant interruption by this manufacturer or a termination of a distribution agreement could disrupt the operations of our business units. Future results of operations are also materially dependent upon the continued market acceptance of manufacturers' products and their ability to continue to manufacture products that comply with laws relating to environmental and efficiency standards.

Seasonality

Much of the HVAC industry is seasonal; sales of HVAC equipment and service are generally highest during the times of the year when climatic conditions require the greatest use of such systems. Because of our geographic concentration

in the Sunbelt, our sales of air conditioning products are substantially greater than of heating products. Likewise, our sales volume is highest in the summer months when air conditioning use is greatest. Accordingly, our revenues are higher in our second fiscal quarter ending August 31, and our revenues are lower in our fourth quarter ending the last day of February. Sales of refrigeration equipment, parts, and supplies which are generally to commercial customers, are subject to less seasonality.

New Construction Cyclicality

Unlike the replacement aftermarket, which is seasonal based on weather conditions, the unit sales volume of the new construction segment of the HVAC industry varies based on the economic factors that impact residential and commercial new construction. These factors are historically cyclical and include macroeconomic conditions such as interest rate environment, level of investment activity in real estate compared to alternative investment opportunities, consumer sentiment and availability of mortgage financing. Although we estimate that only about 30% of the Company's sales are related to new construction, if there is a significant reduction in new construction activity for a period of time, the Company's sales and income could be materially affected.

Competition

We operate in highly competitive environments. We compete with a number of independent distributors and also with several air conditioning and heating equipment manufacturers that distribute a significant portion of their products through their own distribution organizations in certain markets. Competition within any given geographic market is based upon product availability, customer service, price and quality. Competitive pressures or other factors could cause our products or services to lose market acceptance or result in significant price erosion, either of which would have a material adverse effect on profitability.

General Risk Factors

Risks Related to Insurance Coverage

We carry general liability, comprehensive property damage, workers' compensation and other insurance coverage that management considers adequate for the protection of the Company's assets and operations. There can be no assurance, however, that the coverage limits of such policies will be adequate to cover losses and expenses for lawsuits brought or which may be brought against us.

A loss in excess of insurance coverage could have a material adverse effect on our financial position and/or profitability. Self-insurance risks related to employee medical benefits and casualty insurance programs are retained by the Company. Reserves are established based on claims filed and estimates of claims incurred but not yet reported. Assurance cannot be provided that actual claims will not exceed present estimates. We limit exposure to catastrophic losses by maintaining excess and aggregate liability coverage and implementing loss control programs.

Information about Forward-Looking Statements

This Form 10-K contains or incorporates by reference statements that are not historical in nature and that are intended to be, and are hereby identified as, "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995, including statements regarding, among other items, (i) business and acquisition strategies, (ii) potential acquisitions, (iii) financing plans and (iv) industry, demographic and other trends affecting the Company's financial condition or results of operations. These forward-looking statements are based largely on management's expectations and are subject to a number of risks and uncertainties, certain of which are beyond their control.

Actual results could differ materially from these forward-looking statements as a result of several factors, including:

- general economic conditions affecting general business spending,
- consumer spending,
- consumer debt levels,
- prevailing interest rates,
- seasonal nature of product sales,

- changing rates of new housing starts,
- weather conditions,
- effects of supplier concentration,
- competitive factors within the HVAC industry,
- insurance coverage risks,
- viability of the Company's business strategy.

In light of these uncertainties, there can be no assurance that the forward-looking information contained herein will be realized or, even if substantially realized, that the information will have the expected consequences to or effects on the Company or its business or operations. A discussion of certain of these risks and uncertainties that could cause actual results to differ materially from those predicted in such forward-looking statements is included in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations". Forward-looking statements speak only as of the date the statement was made. The Company assumes no obligation to update forward-looking information or the discussion of such risks and uncertainties to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information.

Item 1B. ***Unresolved Staff Comments.***

None.

Item 2. ***Properties.***

The Company and its subsidiaries occupy office and warehouse space under operating leases with various terms ranging generally from five to ten years. Many of the leases contain extension options. At February 28, 2007 the Company operated 54 branch locations in 10 states and one distribution center and its corporate headquarters in Houston, Texas. Generally, a branch location will contain 15,000 to 30,000 square feet of showroom and warehouse space. Branch locations that include a subsidiary's corporate office are sometimes larger. The Company owns its branch facilities in Pasadena, TX and Gainesville, FL, and a building and land that are leased to the company that purchased the Company's filter manufacturing operations in 2004. All of the owned properties are subject to mortgage liens. For further details see Note 4 to the Company's financial statements.

Item 3. ***Legal Proceedings.***

We are subject to various legal proceedings arising in the ordinary course of business. We vigorously defend all matters in which the Company or its business units are named defendants and, for insurable losses, maintain insurance to protect against adverse judgments, claims or assessments. Although the adequacy of existing insurance coverage or the outcome of any legal proceedings cannot be predicted with certainty, we do not believe the ultimate liability associated with any claims or litigation will have a material impact to our financial condition or results of operations.

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, 2007.

PART II

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

On March 20, 2006, the Company's common stock began trading on the American Stock Exchange® under the symbol "BRR". Prior to that date, the stock was traded in the over-the-counter market under the symbols "ACRG", "ACRG.OB" or "ACRG.BB", depending on the source of the quote.

As of April 30, 2007, there were 393 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.

During fiscal 2007, 2006 and 2005 the Company issued 135,000, 50,000 and 1,084,000 shares, respectively, of unregistered restricted stock of which 386,582 shares were vested at February 28, 2007.

The Company has never declared or paid cash dividends on its common stock. The Company's loan agreement with its senior lender expressly prohibits the payment of dividends by the Company. See Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources, and Note 4 of Notes to Consolidated Financial Statements.

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

		High		Low
Fiscal Year 2007				
1st quarter ended 5/31/06	$	4.15	$	3.45
2nd quarter ended 8/31/06		5.93		3.95
3rd quarter ended 11/30/06		6.47		4.80
4th quarter ended 2/28/07		5.97		4.60
Fiscal Year 2006:				
1st quarter ended 5/31/05	$	4.19	$	2.67
2nd quarter ended 8/31/05		3.19		2.33
3rd quarter ended 11/30/05		2.95		2.22
4th quarter ended 2/28/06		3.74		2.78

Stock Performance Graph

The following graph compares the cumulative 5-year total return to shareholders on the Company’s common stock relative to the cumulative total returns of the AMEX Composite index, the NASDAQ Non-Financial index and the DJ Wilshire Building Materials & Fixtures index. An investment of $100 (with reinvestment of all dividends) is assumed to have been made in the company's common stock and in each of the indexes on 2/28/2002 and its relative performance is tracked through 2/28/2007. We have chosen the DJ Wilshire Building Materials & Fixtures index to replace the NASDAQ Non-Financial index as the comparative line-of-business index because we believe it more accurately represents the Company’s industry.

	2/02	2/03	2/04	2/05	2/06	2/07
ACR Group, Inc.	**100.00**	**82.39**	**315.22**	**810.87**	**760.87**	**1002.80**
AMEX Composite	**100.00**	**85.22**	**126.83**	**142.87**	**161.06**	**172.91**
NASDAQ Non-Financial	**100.00**	**76.85**	**114.32**	**115.69**	**127.13**	**133.89**
DJ Wilshire Building Materials & Fixtures	**100.00**	**77.68**	**131.32**	**167.56**	**198.35**	**221.31**

	2/02	2/03	2/04	2/05	2/06	2/07
ACR Group, Inc.		**-17.61%**	**282.59%**	**157.24%**	**-6.17%**	**31.80%**
AMEX Composite		**-14.78%**	**48.82%**	**12.65%**	**12.73%**	**7.35%**
NASDAQ Non-Financial		**-23.15%**	**48.75%**	**1.20%**	**9.89%**	**5.31%**
DJ Wilshire Building Materials & Fixtures		**-22.32%**	**69.04%**	**27.60%**	**18.37%**	**11.58%**

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, 2003, the increase in sales has resulted principally from internal expansion. The Company has never paid any dividends.

The Company's income tax provision in fiscal year 2003 was reduced primarily by the benefit of a previously unrecognized net operating loss carryforward.

The cumulative effect of accounting change in fiscal 2003 was attributable to the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets".

Selected Financial Data
(in thousands, except per share data)

	Year Ended February 28 or 29,				
	2007	**2006**	**2005**	**2004**	**2003**
Income Statement Data:					
Sales	$ 239,643	$ 204,312	$ 199,553	$ 174,353	$ 161,822
Gross profit	61,036	48,331	46,645	38,558	35,673
Operating income	10,994	5,134	7,330	4,452	2,690
Income before income taxes	9,286	4,558	6,799	3,759	1,277
Provision for income taxes	(3,544)	(1,804)	(2,588)	(1,364)	(277)
Cumulative effect of accounting change	—	—	—	—	(483)
Net income	$ 5,742	$ 2,754	$ 4,211	$ 2,395	$ 517
Earnings (loss) per common share:					
Basic:					
Before cumulative effect of accounting change	$ .51	$ .25	$ .39	$ .22	$ .09
Cumulative effect of accounting change	—	—	—	—	(.04)
	$ .51	$ .25	$ .39	$ .22	$ .05
Diluted:					
Before cumulative effect of accounting change	$ .49	$ .24	$ .38	$ .22	$ .09
Cumulative effect of accounting change	—	—	—	—	(.04)
	$ .49	$ .24	$ .38	$ .22	$ .05

	As of February 28 or 29,				
	2007	**2006**	**2005**	**2004**	**2003**
Balance Sheet Data:					
Working capital	$ 41,692	$ 34,489	$ 35,375	$ 25,881	$ 22,605
Total assets	83,160	76,036	67,704	58,727	52,728

Long-term obligations	26,314	24,872	27,881	23,258	22,855
Shareholders’ equity	27,286	21,146	17,704	13,058	10,663

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

Results of Operations

The following table presents information derived from the consolidated statements of income expressed as a percentage of revenues for the years ended February 28, 2007, 2006 and 2005.

	Fiscal Year Ended February 28,		
	2007	**2006**	**2005**
Sales	100.0%	100.0%	100.0%
Cost of sales	74.5	76.3	76.6
Gross profit	25.5	23.7	23.4
Selling, general and administrative expenses	20.9	21.1	19.7
Operating income	4.6	2.6	3.7
Interest expense	1.0	0.7	0.5
Interest derivative loss (gain)	-	(0.1)	0.1
Other non-operating income	(0.3)	(0.3)	(0.3)
Income before income taxes	3.9	2.3	3.4
Income taxes	1.5	0.9	1.3
Net income	2.4%	1.4%	2.1%

Disclosures below that refer to "same-store" comparisons exclude branch operations that were opened or closed after the beginning of fiscal 2006. We opened five branches in fiscal 2007 and two branches after the beginning of fiscal 2006. In addition, we acquired two branch operations effective as of the beginning of fiscal 2006. There were no branches closed in either fiscal year.

Comparison of Fiscal Year Ended February 28, 2007 to Fiscal Year Ended February 28, 2006

Net income increased 109% in fiscal 2007 compared to fiscal 2006, as operating results improved at each of our five business units. The largest gains in operating income occurred at our business units in the southeastern U.S., as our business unit based in Florida continued a string of consecutive years in which its profitability has grown significantly. Our business unit based in Georgia recovered from fiscal 2006, when it had an operating loss that resulted largely from transitioning the primary line of HVAC equipment that it sells.

We generally expect that new branch operations may be unprofitable for the first 12 to 18 months of operations although, historically, some new branch operations have become profitable in less than 12 months, and in other cases, branches have incurred losses for longer than 18 months from inception. Aggregate operating losses of branches opened or acquired in fiscal 2007 and 2006 were $430,000 and $190,000, respectively, thereby reducing earnings per share in fiscal 2007 by $0.02 and in fiscal 2006 by $0.01.

Consolidated sales increased 17% in fiscal 2007 compared to fiscal 2006, and same-store sales increased 13% from fiscal 2006 to 2007. The increase in same-store sales resulted from strong demand for our products, especially during the first two quarters of fiscal 2007, a transition to higher efficiency air conditioning equipment that sells for higher prices, and increases in the costs of commodity-based products such as copper and steel that resulted in higher unit sale prices. All of the increase in sales from fiscal 2006 to fiscal 2007 was organic; the Company made no acquisitions in fiscal 2007.

Our gross margin on sales increased to 25.5% in fiscal 2007 from 23.7% in fiscal 2006. All of the increase was attributable to point-of-sale pricing. Higher selling margins in fiscal 2007 reflected our ability to sell higher efficiency HVAC equipment, which was mandated by the federal government, at higher margins in fiscal 2007 than we obtained on less efficient equipment in fiscal 2006. In addition, we were able to command higher margins in fiscal 2007 on our remaining inventory of lower efficiency equipment because of the finite supply that resulted after production of such products was phased out late in fiscal 2006.

Selling, general and administrative ("SG&A") expenses expressed as a percentage of sales declined to 20.9% in fiscal 2007 from 21.1% in fiscal 2006. Same-store SG&A expenses increased 11% in fiscal 2007 compared to fiscal 2006, principally because of variable expenses associated with higher levels of sales, gross profit and operating income in fiscal 2007. Excluding commissions and other incentive compensation, same-store SG&A expenses increased 5% from fiscal 2006 to 2007. Total payroll costs were 58% and 57% of SG&A expenses in fiscal 2007 and 2006, respectively. Variable compensation increased from 12% of SG&A expenses in fiscal 2006 to 15% of SG&A expenses in fiscal 2007.

Interest expense increased 65% in fiscal 2007, compared to fiscal 2006, reflecting both higher average interest rates on our variable rate debt and a higher average level of outstanding borrowings in fiscal 2007. Average outstanding funded debt was $35.0 million in fiscal 2007, compared to $27.2 million in fiscal 2006, as we used our line of credit to support working capital requirements associated with the higher volume of sales in fiscal 2007 and our investment in new branch operations. As a percentage of sales, interest expense was 1.0% in fiscal 2007 and 0.7% in fiscal 2006.

Until October 2006, our interest rate swap agreements did not qualify for hedge accounting and were accounted for as investments. So long as the swap agreements were accounted for as investments, changes in the market value of the agreements were reflected as interest derivative gain or loss in our statements of income. In fiscal 2007 and 2006, the swap agreements generated gains of $84,000 and $247,000, respectively, based on both monthly payments received for the difference between the fixed rate stated in the swap agreements and the market rate and changes in the market value of the instruments. Other non-operating income, which consists principally of finance charges collected from customers, declined 1% in fiscal 2007 from fiscal 2006.

The Company's effective tax rate was 38.2% in fiscal 2007, compared to 39.6% in fiscal 2006. The effective tax rate declined primarily due to lower state income taxes resulting from a shift of earnings to lower tax states compared to fiscal 2006.

Comparison of Fiscal Year Ended February 28, 2006 to Fiscal Year Ended February 28, 2005

Net income declined to $2,754,000 in fiscal 2006 from $4,211,000 in fiscal 2005, a decline of 35%. The decline in net income from fiscal 2005 to fiscal 2006 was a result of a reduction in sales at the Company's business units based in Georgia and in Colorado from termination of the rights to distribute the Goodman brand of HVAC equipment in February 2005. Although these business units secured distribution rights for other brands of comparable equipment, there were initial delays in obtaining an appropriate quantity and mix of inventory at each affected branch location. Subsequently, these business units experienced difficulty through the remainder of the fiscal year converting a significant percentage of their customers to the new equipment brands. In fiscal 2005, Goodman equipment had represented approximately 60% and 20% of sales by the Georgia and Colorado-based business units, respectively. Operating income at these two business units declined by $4.2 million in fiscal 2006 compared to fiscal 2005. The combined operating income at the Company's other branch operations that were not affected by the Goodman brand transition increased $2.1 million, or 28%, in fiscal 2006 over fiscal 2005, with the Florida-based business unit delivering strong growth in both sales and income.

Same-store sales decreased 3% in fiscal 2006 compared to fiscal 2005. The fiscal 2006 comparison was significantly affected by the decline in sales of Goodman brand equipment described above. At the branch operations that did not

sell Goodman brand equipment, same-store sales increased 17% in fiscal 2006 over fiscal 2005. Sales growth in fiscal 2006 was strong throughout the year in both Florida and Nevada, buoyed by robust regional economies and new housing starts. In Texas, favorable economic and weather conditions boosted sales during the last two quarters of fiscal 2006. An acquisition in Florida also added $3.2 million to sales in fiscal 2006.

The Company's gross margin percentage was 23.7% in fiscal 2006, compared to 23.4% in fiscal 2005. The increase in gross margin percentage from fiscal 2005 to fiscal 2006 resulted entirely from greater purchase volume rebates and payment discounts, rather than point-of-sale pricing.

Consolidated selling, general and administrative ("SG&A") expenses increased 10% in fiscal 2006 from fiscal 2005. Expressed as a percentage of sales, SG&A expenses were 21.1% in fiscal 2006, compared to 19.7% in fiscal 2005. Same-store SG&A expenses increased 4% in fiscal 2006 from 2005. At the business units that suffered sales declines in fiscal 2006 from the equipment brand transition, management did not undertake corresponding cost reduction measures, which would have required forced staff reductions, but allowed attrition to reduce SG&A expenses below prior year levels. Total payroll costs were 57% and 58% of SG&A expenses in fiscal 2006 and 2005, respectively. Variable compensation decreased from 14% of SG&A expenses in fiscal 2005 to 12% of SG&A expenses in fiscal 2006, as a result of lower operating income in fiscal 2006.

Interest expense increased 41% in fiscal 2006 due principally to short-term interest rates that rose continuously during the year. Average funded indebtedness increased 8% over fiscal 2005, as the Company used its revolving credit line for working capital both to access favorable payment terms with suppliers and to finance customer receivables and inventories associated with new branch operations. In fiscal 2006 and 2005, interest expense was 0.7% and 0.5% of sales, respectively. As described above, the Company's interest rate swap agreements were accounted for as investments in fiscal 2006 and 2005. Such agreements generated a gain of $247,000 in fiscal 2006 and a loss of $50,000 in fiscal 2005, based on monthly payments made or received for the difference between the fixed rate and the market rate and changes in the market value of the derivatives. Such gains and losses are principally a function of changes in the expected yield on long-term debt instruments. Other non-operating income, which consists principally of finance charges collected from customers, increased 15% from fiscal 2005 to 2006.

An increase in the Company's effective tax rate from 38.1% in fiscal 2005 to 39.6% in fiscal 2006 occurred primarily due to higher state income taxes in 2006.

Liquidity and Capital Resources

The Company used $0.3 million of cash in operations in fiscal 2007 compared to generating $3.7 million cash flow from operations in fiscal 2006. The positive cash flow generated in fiscal 2006 resulted principally from extended payment terms that the Company negotiated with its largest supplier for inventory shipments in the fourth quarter of the fiscal year. In March 2006, the Company paid $3.6 million to the supplier pursuant to the extended payment terms. Accounts receivable represented 46 days of gross sales at the end of fiscal 2007, compared to 45 days at the end of fiscal 2006. Inventories increased $5.3 million from February 28, 2006 to February 28, 2007, of which $3.7 million was at branch operations that we opened in fiscal 2007.

The Company made capital expenditures of $1.8 million in fiscal 2007, compared to $1.5 million in fiscal 2006. A majority of the assets acquired by the Company in both fiscal years were for leasehold improvements at new and relocated branch operations and for warehouse equipment.

Net cash provided by financing activities was $1.2 million in fiscal 2007, compared to net cash used in financing activities of $3.2 million in fiscal 2006. The Company utilizes a cash management system that applies cash generated from operations, as discussed above, to reduce indebtedness under its revolving credit line. The additional funds borrowed in fiscal 2007 were for new branch openings.

As of February 28, 2007, the Company has a credit arrangement ("Agreement") with a commercial bank, which includes both a $45 million revolving line of credit and a $5 million credit line that may be used for capital expenditures or to purchase real estate. The amount that may be borrowed under the revolving credit line is limited to a borrowing base consisting of 85% of eligible accounts receivable, and from 50% to 65% of eligible inventory, depending on the time

of year. At February 28, 2007, the Company's available credit under the revolver was $11.2 million. The Agreement terminates in August 2008.

As of February 28, 2007, the Company had outstanding borrowings of $24,361,000 on the revolving line of credit and $624,000 under the capital expenditure facility. In addition, the Company had an outstanding letter of credit for $926,000 against the line of credit. Borrowings under the capital expenditure facility are repaid in equal monthly principal installments of $6,593 plus interest.

Borrowings under both facilities bear interest based on the prime rate or LIBOR, plus a spread that is dependent on the Company's financial performance. As of February 28, 2007, the applicable interest rate on both facilities was the prime rate, or LIBOR plus 1.375%, and the Company had elected the LIBOR option (5.375%) at February 28, 2007 for substantially all amounts outstanding under the facilities. A commitment fee of 0.25% is paid on the unused portion of the revolving credit line.

The Agreement contains customary loan covenants with respect to the Company's net worth, fixed charge coverage, leverage ratio, and ratio of funded debt to earnings before interest, income tax, depreciation, amortization and non-cash compensation expense. The Agreement also contains various affirmative and negative covenants unrelated to the Company's financial performance, including a prohibition on payment of dividends. Failure to comply with any financial or non-financial covenant, if not promptly cured, constitutes an Event of Default under the Agreement. Certain other specified events and any Material Adverse Change, as determined by the bank, also constitute an Event of Default. The existence of an Event of Default gives the bank a right to accelerate all outstanding indebtedness under the Agreement. As of February 28, 2007, the Company was in compliance with all of the required financial and non-financial covenants.

The Agreement does not require the Company to use lockbox or similar arrangements pursuant to which the bank would exercise control over collection proceeds and the discretion to reduce indebtedness under the Agreement. If an event of default exists, the bank may offset against the Company's indebtedness all funds of the Company that are held in accounts at the bank. The Company is not required to maintain deposit balances at the bank, although the Company has elected to utilize the bank's treasury management services.

We expect that cash flows from operations and the borrowing availability under our revolving credit facility will provide sufficient liquidity to meet the Company's normal operating requirements, debt service and expected capital expenditures. Subject to limitations set forth in the Agreement, funds available under the revolving credit facility may be utilized to finance acquisitions.

Contractual Obligations and Off-Balance Sheet Arrangements

The Company's future contractual obligations and potential commercial commitments as of February 28, 2007 are summarized as follows (in thousands):

	Payments Due by Period				
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**After 5 Years**
Revolving credit facility	$ 24,361		$ 24,361		
Long-term debt	1,345	131	627	74	513
Capital lease obligations	572	160	303	109	
Operating leases	30,836	7,806	12,771	7,060	3,199
Estimated interest payments	4,173	2,488	1,343	145	197
Total Contractual Obligations (including interest)	$ 61,287	$ 10,585	$ 39,405	$ 7,388	$ 3,909

Other Commercial Commitments	**Amounts Committed**	**Expiration Per Period Less Than 1 Year**
Consigned inventory	$ 6,278	$ 6,278
Standby letter of credit	926	926
Total Other Commercial Commitments	$ 7,204	$ 7,204

As described above under Liquidity and Capital Resources, most of the Company's indebtedness bears interest at variable rates. In addition, borrowings outstanding under the revolving credit line fluctuate. The estimated interest payments reflected in the table above are based on both the amount outstanding under the revolving credit facility and the variable interest rate in effect as of February 28, 2007.

In October 2006 the Company entered into two interest rate swap agreements totaling $20 million whereby the Company has agreed to exchange, at monthly intervals, the difference between the fixed rates of 5.04% and 5.07% and LIBOR, amounts as calculated by reference to a notional principal amount of $10 million on each interest rate swap agreement. The interest rate swaps mature in November 2009 and 2011 respectively.

At inception, the derivatives qualify for hedge accounting. The fair value of the derivatives represented a liability of $142,963 at February 28, 2007. The derivatives were effective as hedges at February 28, 2007. The liability to record the hedges at fair value will only be realized if the Company terminates the derivative contracts prior to maturity.

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

Consigned inventory is held at a majority of the Company's branch locations in Texas, California and Georgia. Under terms of the consignment program, the Company pays for such inventory in the month after it is sold. The supplier of the consigned inventory, Haier USA, retains title and legal control over the inventory until it is purchased by the Company.

The Company customarily issues purchase orders to suppliers for inventory based on current requirements. Such purchase orders are usually fulfilled by suppliers, and accepted by the Company, in less than sixty days. Most of such orders do not represent contractual obligations and may be amended or canceled prior to fulfillment.

A standby letter of credit is used as collateral under a self-insurance program for workers' compensation, general liability and vehicles. The letter of credit is not expected to result in any material loss or obligation, as insurance claims under the program are paid in the ordinary course of business.

The Company has no off-balance sheet arrangements. The Company has not entered into any transactions with unconsolidated entities such as special-purpose entities that would be established for the purpose of facilitating off-balance sheet arrangements.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Standards ("SFAS") No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The provisions of SFAS No. 157 are effective for the Company beginning March 1, 2008. We are currently evaluating the impact of adopting SFAS No. 157 on our consolidated financial statements but the Company believes the impact, if any, will not be material to the consolidated financial statement.

In September 2006, the SEC issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB No. 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB No. 108 requires companies to quantify misstatements using a balance sheet and income statement approach and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. SAB No. 108 permits existing public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii) recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying value of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained

earnings. Use of the “cumulative effect” transition method requires detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose. The adoption of SAB No. 108 did not have a material impact on the Company’s consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, “Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109” (“FIN No. 48”). This interpretation clarifies the accounting for uncertainty in income taxes recognized in a company’s financial statements in accordance with SFAS No. 109, “Accounting for Income Taxes.”

This interpretation seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, it requires expanded disclosure with respect to the uncertainty in income taxes. FIN No. 48 is effective for fiscal years beginning after December 15, 2006; thus, the Company's effective date is March 1, 2007. The Company has not evaluated the potential impact to the consolidated financial statements, but believes the impact if any, is not expected to be material to the consolidated financial statements.

Critical Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make assumptions and estimates that affect reported amounts and related disclosures. Actual results, once known, may vary from these estimates. We base our estimates on historical experience, current trends and other factors that are believed to be reasonable under the circumstances. We believe that the following accounting policies require a higher degree of judgment in making its estimates and, therefore, are critical accounting policies.

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. We believe that the lack of customer concentration is a significant factor that mitigates the Company's accounts receivable credit risk. Two customers represented 6% and 2% of consolidated fiscal 2007 sales, respectively, and no other customer comprised as much as 1% of sales. The number of customers and their distribution across the geographic areas served by the Company help to reduce the Company's credit exposure to a single customer or to economic events that affect a particular geographic region. Although we believe that our 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 us to record additional allowances.

Inventories

Inventories consist of HVAC equipment, parts and supplies and are valued at the lower of cost or market value using the moving average cost method. At February 28, 2007, all inventories represented finished goods held for sale. 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 HVAC 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 to the consigned inventory. The Company is responsible for damage to and loss of inventory that may occur at its premises.

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

Vendor Rebates

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

Goodwill

Goodwill represents the excess of purchase price paid over the fair value of net assets acquired in connection with business acquisitions. The assessment of recoverability of goodwill requires management to project future operating results and other variables to estimate the fair value of the enterprise. Future operating results can be affected by changes in market or industry conditions.

Self-Insurance Reserves

The Company is self-insured for various levels of general liability, workers' compensation, vehicle, and employee medical coverage. The level of exposure from catastrophic events is limited by stop-loss and aggregate liability reinsurance coverage. When estimating the self-insurance liabilities and related reserves, the Company considers a number of factors, which include historical claims experience, demographic factors and severity factors. If actual claims or adverse development of loss reserves occurs and exceed these estimates, additional reserves may be required that could materially impact the consolidated results of operations.

Interest Rate Derivative Instruments

The Company has interest rate derivatives that qualify for hedge accounting in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. The fair value of these derivative instruments is reflected on the Company's balance sheets, and changes in the fair value of such derivatives are recorded net of deferred tax benefit in other comprehensive loss. Payments received or paid by the Company during the term of the derivative contract as a result of differences between the fixed interest rate of the derivative and the market interest rate are recorded as adjustments to interest expense.

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 applicable 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 that affect the level of construction activity.

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 bank 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. The Company may, at its option, fix the interest rate for borrowings under the facility based on a spread over LIBOR for 30 days to 3 months.

At February 28, 2007 the Company had $25.0 million outstanding under its bank credit facility, of which $5.0 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 $50,000, and no change per basic share, on an annual basis. The Company has two interest rate derivative instruments of $10 million each for a total notional amount of $20 million that expire in November 2009 and 2011, respectively. The instruments fix LIBOR at 5.04% and 5.07% respectively, on the notional amounts.

Item 8. Financial Statements and Supplementary Data.

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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, 2007 and 2006 and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended February 28, 2007. Our audits also included the financial statement schedule listed in the index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion of the effectiveness of the Company's internal control over financial reporting. Accordingly we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedule, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and the schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ACR Group, Inc. and subsidiaries at February 28, 2007 and 2006 and the results of their operations and their cash flows for each of the three years in the period ended February 28, 2007, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the Consolidated Financial Statements, effective March 1, 2006, the Company adopted the provisions of FAS 123(R) "Share-based Payments".

Also, in our opinion, the schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein for the years ended February 28, 2007, 2006 and 2005.

BDO Seidman, LLP

Houston, Texas
May 25, 2007

ACR GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands)

ASSETS

	February 28, 2007	2006
Current assets:		
Cash	$ 1,135	$ 1,275
Accounts receivable, net	23,330	22,380
Inventories, net	43,516	38,264
Prepaid expenses and other current assets	1,619	1,250
Deferred income taxes	1,652	1,338
Total current assets	71,252	64,507
Property and equipment, net	5,647	4,844
Goodwill	5,408	5,408
Interest derivative asset		298
Other assets	853	979
Total assets	$ 83,160	$ 76,036

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

ACR GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

LIABILITIES AND SHAREHOLDERS' EQUITY

	February 28, 2007	February 28, 2006
Current liabilities:		
Current maturities of long-term debt	$ 131	$ 128
Current maturities of capital lease obligations	160	145
Accounts payable	23,106	25,002
Accrued expenses and other current liabilities	5,931	4,597
Income tax payable	232	146
Total current liabilities	29,560	30,018
Borrowings under revolving credit agreement	24,361	22,940
Long-term notes, net of current maturities	1,214	1,344
Long-term capital lease obligations, net of current maturities	412	248
Interest derivative liability	143	
Deferred income taxes	184	340
Total long-term liabilities	26,314	24,872
Commitments and contingencies (Notes 5 and 10)		
Shareholders' equity:		
Preferred stock, $.01 par, authorized 2,000,000 shares, none outstanding		
Common stock, $.01 par, authorized 25,000,000 shares, 12,113,078 and 12,000,294 issued and outstanding at February 28, 2007 and 2006, respectively	121	120
Paid-in capital	43,286	44,413
Accumulated other comprehensive loss, net of tax	(88)	
Unearned restricted stock compensation		(1,612)
Accumulated deficit	(16,033)	(21,775)
Total shareholders' equity	27,286	21,146
Total liabilities and shareholders' equity	$ 83,160	$ 76,036

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

ACR GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

	For the Years Ended February 28,		
	2007	**2006**	**2005**
Sales	$ 239,643	$ 204,312	$ 199,553
Cost of sales	178,607	155,981	152,908
Gross profit	61,036	48,331	46,645
Selling, general and administrative expenses	50,042	43,197	39,315
Operating income	10,994	5,134	7,330
Interest expense	2,451	1,489	1,060
Interest derivative (gain) loss	(84)	(247)	50
Other non-operating income	(659)	(666)	(579)
Income before income taxes	9,286	4,558	6,799
Provision (benefit) for income taxes:			
Current	3,960	1,577	2,709
Deferred	(416)	227	(121)
Net income	$ 5,742	$ 2,754	$ 4,211
Earnings per common share:			
Basic	$ .51	$ .25	$ .39
Diluted	$ .49	$ .24	$ .38

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

ACR GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(in thousands, except share data)

	No. of Shares Outstanding	Par Value	Paid-in Capital	Unearned Restricted Stock Compensation	Accumulated Other Comprehensive Income (loss)	Accumulated Deficit	Total
Balance, February 29, 2004	10,681,294	$ 107	$ 41,691	$ —	$ —	$ (28,740)	$ 13,058
Issuances of shares of restricted common stock	1,084,000	11	2,261	(2,272)	—	—	—
Stock issuances from exercise of stock options	39,000	—	46	—	—	—	46
Amortization of unearned restricted stock compensation	—	—	—	389	—	—	389
Net income	—	—	—	—	—	4,211	4,211
Balance, February 28, 2005	11,804,294	118	43,998	(1,883)	—	(24,529)	17,704
Issuances of shares of restricted common stock	50,000	1	136	(137)	—	—	—
Stock issuances from exercise of stock options	146,000	1	171	—	—	—	172
Amortization of unearned restricted stock compensation	—	—	—	408	—	—	408
Tax benefit from restricted stock compensation	—	—	108	—	—	—	108
Net income	—	—	—	—	—	2,754	2,754
Balance, February 28, 2006	12,000,294	120	44,413	(1,612)	—	(21,775)	21,146
Effect of adoption of SFAS 123(R)	—						