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COLONIAL COMMERCIAL CORP
Form 10-Q
June 03, 2004

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED MARCH 31, 2004 COMMISSION FILE NO. 1-6663

COLONIAL COMMERCIAL CORP.
(Exact Name of Company as Specified in its Charter)

NEW YORK

11-2037182

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification Number)

120 NEW SOUTH ROAD, HICKSVILLE, NEW YORK

11801

(Address of Principal Executive Offices)

(Zip Code)

Company's Telephone Number, Including Area Code: 516-681-4647

Indicate by check mark whether the Registrant is an accelerated filer
(as defined in Rule 12b-2 of the Exchange Act).

Yes

No X

-

Indicate by check mark whether the Company (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 Company was
required to file such reports) and (2) has been subject to such filing
requirements for the past 90 days.

Yes X

No

-

Indicate the number of shares outstanding of the Company's Common Stock and
Convertible Preferred Stock as of June 1, 2004.

Common Stock, par value \$.05 per share - 3,013,768 shares
Convertible Preferred Stock, par value \$.05 per share - 863,612 shares

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COLONIAL COMMERCIAL CORP. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

COLONIAL COMMERCIAL CORP. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets

Assets

MARCH 31
2004

DECEMBER
2003

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	(Unaudited)	
Current assets:		
Cash and cash equivalents	\$ 461,888	\$ 342,
Accounts receivable, net of allowance for doubtful accounts of \$334,000 in 2004 and \$285,000 in 2003	6,554,418	6,253,
Inventory	9,863,121	9,782,
Prepaid expenses and other current assets	694,956	620,
Deferred tax asset	551,000	421,
	-----	-----
Total current assets	18,125,383	17,421,
Property and equipment	1,607,899	1,515,
Goodwill	1,628,133	1,628,
Other intangibles	43,751	54,
	-----	-----
	\$ 21,405,166	\$ 20,618,
	=====	=====
Liabilities and Stockholders' Equity		
Current liabilities:		
Trade payable	\$ 5,796,533	\$ 5,295,
Accrued liabilities	1,438,101	1,513,
Income taxes payable	126,827	175,
Borrowings under credit facility	12,873,408	12,232,
Notes payable - current portion	97,981	104,
	-----	-----
Total current liabilities	20,332,850	19,321,
Notes payable, excluding current portion	311,322	326,
	-----	-----
Total liabilities	20,644,172	19,648,
	-----	-----
Commitments and contingencies		
Stockholders' equity:		
Redeemable convertible preferred stock, \$.05 par value, liquidation preference of \$4,356,810 and \$7,333,960 and 2,468,860 shares authorized, 871,362 in 2004 and 1,466,792 in 2003 shares issued and outstanding	43,568	73,
Common stock, \$.05 par value, 20,000,000 shares authorized, 3,006,018 in 2004 and 2,403,318 in 2003 shares issued and outstanding	150,302	120,
Additional paid-in capital	9,347,912	9,259,
Accumulated deficit	(8,780,788)	(8,481,
	-----	-----
Total stockholders' equity	760,994	970,
	-----	-----
	\$ 21,405,166	\$ 20,618,
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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COLONIAL COMMERCIAL CORP. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Unaudited)

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2004	2003
Sales	\$ 12,525,359	\$ 8,357,683
Cost of sales	8,715,380	5,892,239
	-----	-----
Gross profit	3,809,979	2,465,444
Selling, general and administrative expenses, net	4,099,052	2,550,887
	-----	-----
Operating loss	(289,073)	(85,443)
Interest income	67	153
Other income	56,650	84,005
Interest expense	(179,915)	(150,541)
	-----	-----
Loss before income tax benefit	(412,271)	(151,826)
Income tax benefit	(113,021)	(82,742)
	-----	-----
Net loss	\$ (299,250)	\$ (69,084)
	=====	=====
Loss per common share:		
Basic	\$ (0.11)	\$ (0.04)
Diluted	\$ (0.11)	\$ (0.04)
Weighted average shares outstanding:		
Basic	2,726,692	1,603,794
Diluted	2,726,692	1,603,794

See accompanying notes to unaudited condensed consolidated financial statements.

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COLONIAL COMMERCIAL CORP. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)

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FOR THE THREE MONTHS ENDED
MARCH 31,
2004 2003

Cash flows from operating activities:		
Net loss	\$ (299,250)	\$ (69,084)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Deferred tax benefit	(129,600)	--
Provision for allowance for doubtful accounts	66,384	25,135
Stock-based compensation	84,900	--
Depreciation	95,811	45,373
Amortization of intangibles	10,416	10,417
Changes in assets and liabilities:		
Accounts receivable	(366,902)	587,646
Inventory	(80,299)	(241,460)
Prepaid expenses and other current assets	(74,278)	31,840
Trade payable	500,655	622,751
Accrued liabilities	(75,477)	(188,145)
Income taxes payable	(48,787)	(40,230)
	-----	-----
Net cash (used in) provided by operating activities	(316,427)	784,243
	=====	=====
Cash flows from investing activities:		
Additions to property and equipment	(188,579)	(44,586)
	-----	-----
Net cash used in investing activities	(188,579)	(44,586)
	-----	-----
Cash flows from financing activities:		
Payments on notes payable	(21,602)	(7,722)
Issuance of common stock	360,000	--
Retirement of preferred stock	(355,638)	--
Net borrowings (repayments) under credit facility	641,378	(309,523)
	-----	-----
Net cash provided by (used in) financing activities	624,138	(317,245)
	-----	-----
Increase in cash and cash equivalents	119,132	422,412
Cash and cash equivalents - beginning of period	342,756	296,764
	-----	-----
Cash and cash equivalents - end of period	\$ 461,888	\$ 719,176
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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Notes To Condensed Consolidated Financial Statements

March 31, 2004
(Unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PRACTICES

The consolidated financial statements of Colonial Commercial Corp. and Subsidiaries (the "Company") included herein have been prepared by the Company and are unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments), which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations, and cash flows for the interim periods to which the report relates. The results of operations for the three months ended March 31, 2004 are not necessarily indicative of the operating results that may be achieved for the full year.

Certain information and footnote disclosures, normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2003.

The Company has one industry segment - wholesale distributor of heating, ventilation and air conditioning.

Inventory is comprised of finished goods.

STOCK OPTIONS

The Company uses the intrinsic-value method of accounting for stock-based awards granted to employees. No stock-based compensation cost is included in net loss, related to options granted during periods presented had an exercise price equal to the market value of the stock on the date of grant and all outstanding options are fully vested. No options were granted during the three-month period ended March 31, 2004. During the three months ended March 31, 2003, 104,000 stock options were granted at market price and were fully vested. In accordance with SFAS No. 148, "Accounting for Stock Based Compensation - Transition and Disclosure," the following table presents the effect on net loss and net loss per share had compensation cost for the Company's stock plans been determined consistent with SFAS No. 123. The fair value of each option grant is estimated on the date of grant by use of the Black-Scholes option pricing model.

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For the Three
Months
Ended
March 31,

2004

2003

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	----	----
Net loss, as reported	\$ (299,250)	(69,084)
Add: stock-based compensation related to option repricing	84,900	--
Deduct: stock-based compensation expense determined under fair value method for all stock options, net of related income tax benefit	--	(26,000)
	-----	-----
Pro forma net loss	(214,350)	(95,084)
Basic income (loss) per share, as reported	(0.11)	(.04)
Basic income (loss) per share, pro forma	(0.08)	(.06)
Diluted income (loss) per share, as reported	(0.11)	(.04)
Diluted income (loss) per share, pro forma	(0.08)	(.06)

(2) EQUITY TRANSACTIONS

On February 12, 2004, the Company completed a private placement, pursuant to Regulation D of the Securities Exchange Act of 1933. The Company raised \$360,000 through the issuance of 600,000 shares of common stock at \$0.60 per share. Bernard Korn (Chairman and President of the Company) purchased 165,000 shares, William Pagano (Director of the Company and President of Colonial Commercial Corp.'s ("Colonial") wholly owned subsidiary, Universal Supply Group, Inc.) ("Universal"), purchased 165,000 shares, and Rita Folger (a private investor who owns 11.4% of the Company) purchased 100,000 shares. The remaining 170,000 shares were purchased by a private investor who owns less than 5% of the Company.

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The Company has used substantially all of the proceeds from the private placement to purchase 592,730 shares of escheated convertible preferred stock at \$0.60 per share from the State of Ohio. The Company has retired these convertible preferred shares.

The stock from the private placements cannot be sold, transferred or otherwise disposed of, unless subsequently registered under the Securities Act of 1933 and applicable state or Blue Sky laws, or pursuant to an exemption from such registration, which is available at the time of desired sale, and bear a legend to that effect.

During the three months ended March 31, 2004, the Company converted a total of 2,700 shares of redeemable convertible preferred stock for 2,700 shares of the Company's common shares.

(3) SUPPLEMENTAL CASH FLOW INFORMATION

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The following is supplemental information relating to the consolidated statements of cash flows:

	Three Months Ended	
	MARCH 31, 2004	MARCH 31, 2003
Cash paid during the period for:		
Interest	\$ 154,484	\$ 129,887
Income taxes	\$ 131,212	\$ --

(4) NET LOSS PER COMMON SHARE

Employee stock options totaling 245,500 and 223,900 for the three months ended March 31, 2004 and 2003, respectively, were not included in the income per share calculation because their effect would have been anti-dilutive. Convertible preferred stock totaling 871,362 and 1,464,252 for the three months ended March 31, 2004 and 2003, respectively were not included in the net loss per share because their effects would have been anti-dilutive.

(5) NEW ACCOUNTING PRONOUNCEMENTS

In January 2003, the FASB issued Financial Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), which clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements." FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not provide sufficient equity at risk for the entity to support its activities. In December 2003, the FASB revised certain elements of FIN 46. The FASB also modified the effective date of FIN 46. FIN 46 is to be applied for registrants who file under Regulation S-X in periods ending after March 15, 2004. The adoption of FIN 46 did not have a material impact on the Company's consolidated financial position or results of operations.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This report on Form 10-Q contains forward-looking statements relating to such matters as anticipated financial performance and business prospects. When used in this report, the words, "anticipates," "expects," "believes," "may," "intends," and similar expressions are intended to be among the statements that identify forward-looking statements. From time to time, the Company may also publish forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Forward-looking statements involve risks and uncertainties, including, but not limited to, the consummation of certain events referred to in this report, technological changes, competitive factors, maintaining customer and vendor relationships,

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inventory obsolescence and availability, and other risks detailed in the Company's periodic filings with the Securities and Exchange Commission, which could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company's forward-looking statements.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires that we make estimates and judgments that affect the amounts reported of assets and liabilities, revenues and expenses and the related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions we believe to be applicable and reasonable under the current circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

In addition, we are periodically faced with uncertainties, the outcomes of which are not within our control and will not be known for prolonged periods of time. Some of these uncertainties are discussed below under "Risks and Uncertainties."

We believe the following to be critical accounting policies that affect the most significant estimates and judgments used in the preparation of our consolidated financial statements:

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

ACCOUNTS RECEIVABLE

Accounts receivable consist of trade receivables recorded at original invoice amount, less an estimated allowance for uncollectible accounts. Trade credit is generally extended on a short-term basis; thus trade receivables generally do not bear interest. However, a finance charge may be applied to receivables that are past due. These charges are included as other income. Trade receivables are periodically evaluated for collectibility based on past credit history with customers and their current financial condition. Changes in the estimated collectibility of trade receivables are recorded in the results of operations for the period in which the estimate is revised. Trade receivables that are deemed uncollectible are offset against the allowance for uncollectible accounts. The Company generally does not require collateral for trade receivables.

INVENTORY

Inventory is stated at the lower of cost or market and consists solely of finished goods. Cost is determined using the first-in, first-out method.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets as follows:

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Computer hardware and software	5 years
Furniture and fixtures	5 years
Automobiles	3-5 years

Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the asset.

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GOODWILL AND OTHER INTANGIBLE ASSETS

Prior to January 1, 2002, the Company amortized goodwill and intangible assets using the straight-line method over periods of up to 10 years. Statement of Financial Accounting Standards (SFAS) 142, "Goodwill and Other Intangible Assets," requires that goodwill and intangible assets having indefinite lives not be amortized, but instead be tested for impairment at least annually. Intangible assets determined to have finite lives are amortized over their remaining useful lives.

Results of Operations - Three Months Ended March 31, 2004 and 2003

The Company reported a net loss of \$299,250 for the first quarter of 2004, as compared to a net loss of \$69,084 in the 2003 quarter.

Sales from operations increased by \$4,167,676 or 49.9% over the same period in 2003. The inclusion of RAL Supply Group, Inc. ("RAL"), which was acquired on September 30, 2003, and American/Universal Supply Inc. ("American"), which was a new operation that commenced on or about July 1, 2003, accounted for \$3,099,435 of this increase. The remaining increase in sales was related to increased market penetration in the core business of Universal. Simultaneously, gross margin dollars increased by \$1,344,535 substantially and directly related to the sales increases. Gross margins expressed as a percentage of sales increased from 29.50% in 2003 to 30.42% in 2004, primarily due to increases in sales of deluxe higher margin products.

Selling, general and administrative expenses and cost of operations increased by \$1,548,165 primarily due to the inclusion of expenses related to RAL and American, as well as higher utility rates, fuel costs and insurance expenses.

Salaries and benefits increased by \$670,717 or 44.95% due to additional personnel added by RAL and American, as well as an increase in medical insurance benefits.

Included in the increase in payroll and benefits, medical and hospitalization insurance costs were increased by \$62,656 over the same period last year, an increase of 74.9% due to increased personnel related to RAL and American and a general increase in hospitalization costs.

General insurance costs increased by \$48,903 to \$80,978 or 152.5% of which \$30,620 was related to RAL and American and the balance related to increased sales volume and increased insurance rates.

Depreciation increased by approximately \$51,000 to \$95,811. Of this

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amount, \$34,000 is related to the RAL and American operations.

Interest expense increased by \$29,374 in the 2004 quarter totally related to increased borrowing required to support increased inventory and accounts receivable of RAL and American, which are directly related to increased sales.

The Company recorded a federal tax benefit of \$129,600 for the first quarter of 2004 due to the fact that it expects to be profitable for the remainder of the year. During the first quarter of 2003, the Company recorded a federal tax benefit of \$82,742 due to the receipt of tax refunds not previously accrued.

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Liquidity and Capital Resources

As of March 31, 2004, the Company had \$461,888 in cash and cash equivalents compared with \$342,756 at December 31, 2003.

Between December 31, 2003 and March 31, 2004, there were no material changes in obligations associated with operating agreements, obligations to financial institutions and other long-term debt obligations.

Cash flows used by operations were \$316,427 during the three months ended March 31, 2004. Accounts receivable increased due to customer and product mix. Accounts payable increased due to increased inventory required to prepare for the second quarter air conditioning season and to the utilization of extended terms.

Cash flows used in investing activities of \$188,579 during the three months ended March 31, 2004 were due to the purchase of property.

The cash flows provided by financing activities of \$624,138 were provided from borrowings made on the credit facility of \$641,378 and the sale of 600,000 shares of common stock in a private placement for \$360,000. The cash flows used in financing activities were due primarily to the purchase and retirement of 592,730 shares of preferred stock for \$355,638 and the repayment on notes payable of \$21,602.

At March 31, 2004, amounts outstanding under the credit facility were \$12,873,408, of which \$16,000 represents a term loan payable in April 2004, and \$2,040,000 represent a term loan payable in 45 remaining monthly installments of agreed amounts under an amortization schedule. Although the term loans are payable over specified periods, the Bank can demand payment at any time.

The Company believes that the credit facility is sufficient to finance its current operating needs.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's pre-tax earnings and cash flows are exposed to changes in interest rates, as all borrowings under its credit facility bear interest based on the prime rate plus 0.5%, except for the \$2.5 million term loan, which bears interest at a rate of prime plus 2.5%. A hypothetical 10% adverse change in such rates would increase the pre-tax loss and cash flow by approximately \$ 62,000

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over a one-year period, assuming the borrowing level remains consistent with the outstanding borrowings as of March 31, 2004. The fair value of the borrowings under the credit facility is not significantly affected by changes in market interest rates.

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The Company's remaining interest-bearing obligations are at fixed rates of interest and as such do not expose pre-tax earnings and cash flows to changes in market interest rates. The change in fair value of the Company's fixed rate obligations resulting from a hypothetical 10% adverse change in interest rates would not be material.

ITEM 4. CONTROLS AND PROCEDURES

(a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company's senior management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934 (the "Exchange Act")) designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported as specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow them to make informed decisions regarding required disclosure.

The Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures under the supervision of and with the participation of management, including the Chief Executive Officer and Chief Financial Officer within 90 days prior to the filing date of this report. Based on that evaluation our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective in alerting them to material information required to be included in our periodic Securities and Exchange Commission filings.

(b) CHANGES IN INTERNAL CONTROLS

Subsequent to that evaluation, there have been no significant changes in our internal controls or other factors that could significantly affect these controls after such evaluation.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On January 28, 2002, Atlantic, a wholly-owned subsidiary of the Company, filed a voluntary petition with the U. S. Bankruptcy Court to reorganize under Chapter 11 of the U. S. Bankruptcy Code. The Company and its other operations are not part of the

Chapter 11 filing. The Company does not believe that Atlantic will emerge from the reorganization with any value for the Company.

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits:

- 31.1 Certification of Chief Executive Officer Pursuant to Rule 15d-14 of the Securities and Exchange Act of 1934, as amended, as pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 15d-14 of the Securities and Exchange Act of 1934, as amended, as pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

b. Reports on Form 8-K:

- (i) Form 8-K filed February 25, 2004 to report financial results for the years ended December 31, 2001 and December 31, 2002 and for the quarters ended March 31, June 30 and September 30, 2003.
- (ii) Form 8-K filed March 30, 2004 to report financial results for the year ended December 31, 2003.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: June 1, 2004

COLONIAL COMMERCIAL CORP.

/S/ BERNARD KORN

Bernard Korn,
Chairman of the Board and President

/S/ JAMES W. STEWART

James W. Stewart,
Executive Vice President and Treasurer

