

Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

COLONIAL COMMERCIAL CORP  
Form 10-Q  
November 15, 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 September 30, 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

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

No

Indicate the number of shares outstanding of the Company's Common Stock and Convertible Preferred Stock as of October 31, 2004

Common Stock, par value \$.05 per share - 4,089,372 shares  
Convertible Preferred Stock, par value \$.05 per share - 814,508 shares

COLONIAL COMMERCIAL CORP. AND SUBSIDIARIES

INDEX

Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

PAGE NO.  
-----

PART I. FINANCIAL INFORMATION

Item 1 - Financial Statements

Condensed Consolidated Balance Sheets as of  
September 30, 2004 (Unaudited) and  
December 31, 2003 1

Condensed Consolidated Statements of Operations  
Three Months Ended September 30, 2004  
and 2003 (Unaudited) 2

Condensed Consolidated Statements of Operations  
Nine Months Ended September 30, 2004  
and 2003 (Unaudited) 3

Condensed Consolidated Statements of Cash Flows  
Nine Months Ended September 30, 2004  
and 2003 (Unaudited) 4

Notes to Condensed Consolidated Financial  
Statements (Unaudited) 5

Item 2 - Management's Discussion and Analysis of  
Financial Condition and Results of Operations 10

Item 3 - Quantitative and Qualitative Disclosures About Market Risk 17

Item 4 - Controls and Procedures 17

PART II. OTHER INFORMATION

Item 1 - Legal Proceedings 19

Item 2 - Changes in Securities, Issuer Purchases of Equity Securities 19

Item 3 - Defaults Upon Senior Securities 20

Item 4 - Submission Of Matters To A Vote of Security Holders 20

Item 5 - Other Information 21

Item 6 - Exhibits and Reports on Form 8-K 21

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

COLONIAL COMMERCIAL CORP. AND SUBSIDIARIES  
Condensed Consolidated Balance Sheets

September 30, Decem

Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

	2004	2003
	-----	-----
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 472,225	\$ 1,000,000
Accounts receivable, net of allowance for doubtful accounts of \$409,900 in 2004 and \$285,000 in 2003	8,262,124	6,000,000
Inventory	11,068,271	9,000,000
Prepaid expenses and other current assets	1,062,015	
Deferred tax asset	153,000	
	-----	-----
Total current assets	21,017,635	17,000,000
Property and equipment	1,595,521	1,000,000
Deferred tax asset	914,000	
Goodwill	1,628,133	1,000,000
Other intangibles	30,417	
	-----	-----
	\$ 25,185,706	\$ 20,000,000
	=====	=====
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities:		
Trade payables	\$ 4,915,211	\$ 5,000,000
Accrued liabilities	1,520,840	1,000,000
Income taxes payable	72,167	
Borrowings under credit facility	12,472,475	12,000,000
Notes payable - current portion	104,361	
	-----	-----
Total current liabilities	19,085,054	19,000,000
Notes payable, excluding current portion	1,457,915	
Borrowing under credit facility: term loan	916,667	
	-----	-----
Total liabilities	21,459,636	19,000,000
	-----	-----
Commitments and contingencies		
Stockholders' equity:		
Redeemable convertible preferred stock, \$.05 par value, liquidation preference of \$4,090,055 and \$7,333,960 and 2,468,860 shares authorized, 818,011 shares in 2004 and 1,466,792 shares in 2003 issued and outstanding	40,900	
Common stock, \$.05 par value, 20,000,000 shares authorized, 4,079,369 shares in 2004 and 2,403,318 shares in 2003 issued and outstanding	203,967	
Additional paid-in capital	10,759,411	9,000,000
Accumulated deficit	(7,278,208)	(8,000,000)
	-----	-----
Total stockholders' equity	3,726,070	
	-----	-----
	\$ 25,185,706	\$ 20,000,000
	=====	=====

Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

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

	For The Three Months Ended September 30,	
	2004	2003
	-----	-----
Sales	\$ 16,185,005	\$ 11,321,632
Cost of sales	11,453,648	8,097,564
	-----	-----
Gross profit	4,731,357	3,224,068
Selling, general and administrative expenses, net	4,177,443	2,841,206
	-----	-----
Operating income	553,914	382,862
Other income	58,280	134,780
Interest expense	(249,463)	(149,182)
	-----	-----
Income before income taxes	362,731	368,460
Income tax (benefit) expense	(476,351)	42,801
	-----	-----
Net income	\$ 839,082	\$ 325,659
	=====	=====
Income per common share:		
Basic	\$ 0.22	\$ 0.14
Diluted	0.17	0.08
Weighted average shares outstanding:		
Basic	3,747,715	2,292,468
Diluted	4,940,318	3,881,522

2

See accompanying notes to unaudited condensed consolidated financial statements.

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

	For The Nine Months Ended September 30,	
	2004	2003
	-----	-----
Sales	\$ 44,859,290	\$ 30,368,961
Cost of sales	31,520,092	21,681,398
	-----	-----
Gross profit	13,339,198	8,687,563
Selling, general and administrative expenses, net	12,308,681	8,096,637

Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

Operating income	1,030,517	590,926
Other income	240,557	274,911
Interest expense	(622,515)	(447,606)
Income before income taxes	648,559	418,231
Income tax benefit	(554,778)	(19,163)
Net income	\$ 1,203,337	\$ 437,394
Income per common share:		
Basic:	\$ 0.38	\$ 0.24
Diluted	0.28	0.13
Weighted average shares outstanding:		
Basic	3,164,125	1,833,352
Diluted	4,368,017	3,339,205

3

See accompanying notes to unaudited condensed consolidated financial statements.

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

	For The Nine Months Ended September 30,	
	2004	2003
	----	----
Cash flows from operating activities:		
Net income	\$ 1,203,337	\$ 437,394
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred tax benefit	(645,600)	
Provision for doubtful accounts	196,286	157,500
Stock-based compensation	84,900	
Depreciation	267,244	147,900
Amortization of intangibles	23,750	31,200
Changes in assets and liabilities, net of the effects of acquisitions:		
Accounts receivable	(2,204,510)	(409,400)
Inventory	(1,285,449)	(1,863,900)
Prepaid expenses and other current assets	(441,337)	(305,100)
Trade payables	(380,668)	2,237,000
Accrued liabilities	7,262	(64,800)
Income taxes payable	(103,447)	31,900
Net cash (used in) provided by operating activities	(3,278,232)	399,700

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

### Cash flows from investing activities:

Cash acquired in acquisition of RAL Supply Group, Inc.	--	3,5
Additions to property and equipment	(347,645)	(293,7
Net cash used in investing activities	(347,645)	(290,2

### Cash flows from financing activities:

Issuance of notes payable	1,179,017	73,6
Payments on notes payable	(47,645)	(26,5
Retirement of preferred stock	(355,638)	
Issuance of common stock	1,635,000	240,6
Issuance of warrants	187,500	
Net borrowings (repayments) under credit facility	1,157,112	(206,0
Net cash provided by financing activities	3,755,346	81,6

Increase in cash and cash equivalents	129,469	191,1
Cash and cash equivalents - beginning of period	342,756	296,7
Cash and cash equivalents - end of period	\$ 472,225	\$ 487,8

4

See accompanying notes to unaudited condensed consolidated financial statements.

### COLONIAL COMMERCIAL CORP. AND SUBSIDIARIES

#### Notes To Condensed Consolidated Financial Statements

September 30, 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 period ended September 30, 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 distribution of heating, ventilation and air conditioning equipment.

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

Inventory is comprised of finished goods.

### Stock Options

The Company uses the intrinsic-value method of accounting for stock-based awards granted to employees. The Company recognizes stock-based compensation related to option repricing for options previously awarded. For the three and nine months ended September 30, 2004, the amount of stock-based compensation was \$33,960 and \$84,900, respectively. No stock-based compensation cost is included in net income related to options granted during periods presented, since they had an exercise price equal to the market value of the stock on the date of grant and all outstanding options are fully vested. During the nine months ended September 30, 2004, no stock options were granted and all outstanding options 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 income and net income per share had compensation cost for the Company's stock plans been determined consistent with SFAS No. 123, "Accounting for Stock-Based Compensation. The fair value of each option grant is estimated on the date of grant by use of the Black-Scholes option-pricing model.

-5-

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2004	2003	2004	2003
	----	----	----	----
Net income, as reported	\$1,203,337	437,394	839,082	325,659
Add: Stock-based compensation related to option repricing	84,900	--	33,960	--
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 income	\$1,288,237	411,394	873,042	325,659
	=====	=====	=====	=====
Basic income per share, as reported	.38	.24	.22	.14
	===	===	===	===
Basic income per share, pro forma	.41	.22	.23	.14
	===	===	===	===
Diluted income per share, as reported	.28	.13	.17	.08
	===	===	===	===
Diluted income per share, pro forma	.29	.12	.18	.08
	===	===	===	===

(2) Equity Transaction

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

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.

The Company has used substantially all of the proceeds from the February 12, 2004 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 following is a list of investors who purchased these shares:

Name ----	Amount of Common Shares -----	Cash Consideration -----
Rita C. Folger	100,000	\$ 60,000
Michael Goldman	170,000	\$ 102,000
Bernard Korn	165,000	\$ 99,000
William Pagano	165,000	\$ 99,000
	-----	-----
Total	600,000	\$ 360,000
	=====	=====

-6-

On July 29, 2004, the Company completed a private placement, pursuant to Regulation D of the Securities Act of 1933. The Company raised \$1,050,000 through the issuance of 420,000 shares of common stock at \$1.25 per share and the issuance of \$525,000 of subordinated unsecured convertible notes payable ("Notes"), bearing interest at 11% per annum, payable quarterly, with 50% of the principal payable on the last day of the fourth anniversary and 50% of the principal payable on the last day of the fifth anniversary. The Notes are convertible into 175,000 shares of common stock at \$3.00 per share during the term of the Notes.

The following table lists the purchasers of the private placement dated July 29, 2004:

Name ----	Amount of Common Shares -----	Convertible Note ----	Cash Consideration -----
Richard A. Cancelosi	40,000	\$ 50,000	\$ 100,000
James Fallon	40,000	\$ 50,000	\$ 100,000
Rita Folger	80,000	\$100,000	\$ 200,000
Margret Friedrich	40,000	\$ 50,000	\$ 100,000
Eileen Goldman	20,000	\$ 25,000	\$ 50,000
John A. Hildebrandt	40,000	\$ 50,000	\$ 100,000
Paul H. Hildebrandt	40,000	\$ 50,000	\$ 100,000
William Pagano	80,000	\$100,000	\$ 200,000
William Salek	40,000	\$ 50,000	\$ 100,000
	-----	-----	-----
Total	420,000	\$525,000	\$1,050,000
	=====	=====	=====

On July 30, 2004, the Company completed a private placement with Michael Goldman and Goldman Associates of New York, Inc. pursuant to Regulation D



## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

of the Securities Act of 1933. For total consideration of \$1,500,000, the Company issued to Goldman Associates, Inc. of New York 600,000 shares of common stock at \$1.25 per share, a \$750,000 subordinated secured note payable, earning interest at the prime rate, interest payable quarterly, principal payable on December 31, 2008, and warrants to purchase 150,000 shares of common stock at \$3.00 per share expiring December 31, 2008. The \$187,500 estimated value of the warrants was accounted for as an increase to additional paid in capital and as a discount to the note payable.

These securities were issued in reliance on the exemption set forth in Section 4(2) of the Act from registration requirements under the Act.

During the nine months ended September 30, 2004, the Company converted 56,051 shares of convertible preferred stock to a similar number of common shares.

During October 2004, an additional 3,503 shares of convertible preferred stock converted to a similar number of common shares and the Company issued 6,500 shares of common stock pursuant to the exercise of an outstanding stock option.

-7-

### (3) Financing Arrangements

On July 29, 2004, the Company completed a \$15,000,000 secured loan facility with Wells Fargo Business Credit Inc. consisting of a revolving line of credit including a \$2,000,000 two-year term loan. This represents a \$1,500,000 increase from its previous line of credit. The revolving credit line bears interest at 1/4% below prime, a decrease of 125 basis points from its previous line of credit, and the term loan bears interest at 1/2% above prime, a decrease of 200 basis points from its previous line of credit. The assets of the Company, as well as a pledge of all the outstanding stock of its operating subsidiaries collateralize all loans. The facility contains covenants relating to the financial condition of the Company and its business operations and restricts the payment of dividends and capital expenditures. Availability under the revolving credit line is determined by a percentage of eligible assets as defined in the agreement. The Company used approximately \$12,865,000 of the proceeds of this facility to repay its previous senior lender and will use the balance for additional working capital.

At September 30, 2004, amounts outstanding under the Company's then existing credit facility were \$13,389,142 and \$1,432,376 was available to the company based on available collateral. The Company believes that its credit facility is sufficient to finance its current operating needs.

### (4) Supplemental Cash Flow Information

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

	Nine Months Ended	
	September 30, 2004	September 30, 2003
	-----	-----
Cash paid during the period for:		
Interest	\$ 600,514	\$ 451,314

Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

Income taxes \$ 136,655 \$ --

(5) Net Income Per Common Share

Basic net income per share is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding. Diluted earnings per share reflect, in periods in which they have a dilutive effect, the impact of common shares issuable upon exercise of stock options.

A reconciliation between the numerators and denominators of the basic and diluted income per common share is as follows:

-8-

	For The Nine Months Ended September 30,		For The Three Months Ended September 30,	
	2004	2003	2004	2003
	----	----	----	----
Net income (numerator)	\$1,203,337	437,394	839,082	325,659
	=====	=====	=====	=====
Weighted average common shares (denominator for basic income per share)	3,164,125	1,833,352	3,747,715	2,292,468
Effect of dilutive securities:				
Convertible preferred stock	956,169	1,464,252	839,230	1,464,252
Convertible notes	38,908	--	116,726	--
Stock options	208,815	41,601	236,647	124,802
	-----	-----	-----	-----
Weighted average common and potential common shares out- standing (denominator for diluted income per share)	4,368,017	3,339,205	4,940,318	3,881,522
	=====	=====	=====	=====
Basic net income per share	.38	.24	.22	.14
Diluted net income per share	.28	.13	.17	.08

Warrants to purchase 150,000 shares were not included in the income per share calculation because their effect would have been anti-dilutive.

(6) New Accounting Pronouncements

None

(7) DEFERRED INCOME TAX ASSET

The Company's deferred income tax asset represents certain future tax benefits related to the expected utilization of net operating loss carry forwards. The Company records a valuation allowance against any portion of the deferred income tax asset when it believes, based on the weight of available evidence, it is more likely than not that some portion of the deferred tax asset will not be realized. Events which incurred during the quarter ended September 30, 2004 has caused management to change its valuation allowance related to the realizability of the deferred tax asset.

-9-

As of December 31, 2003 gross deferred tax assets in the amount of \$12,363,783 were reduced by a valuation allowance in the amount of \$11,942,383. Such valuation allowance had been reduced by \$792,469 during the year ending December 31, 2003, to reflect management's then assessment of the likelihood of utilizing net operating losses in the future, based upon improved results of operations during 2003 and upon projections of future taxable income.

In July 2004, the Company entered into a new financing agreement along with two private placements. The combination of the private placements and debt financing provided an additional \$4,050,000 in liquidity. It is management's opinion that this additional liquidity will allow the Company to expand inventory levels while taking advantage of purchase discounts and programs. Management believes that this will ultimately result in increased revenues and gross margin percentages. Therefore, management has adjusted its future income projections as a result of these events.

At September 30, 2004 gross deferred tax assets in the amount of \$12,143,273 have been reduced by a valuation allowance in the amount of \$11,076,273. Such valuation allowance includes a reduction of \$645,600 during the three months ended September 30, 2004 based upon its adjustment of its future income and taxable income projections and, accordingly, its reassessment of the likelihood of utilizing net operating loss carry forwards in the future. Management's reassessment is based upon its belief that the events set forth in the preceding paragraph will ultimately result in increased revenues and gross margins.

During the three and nine months periods ended September 30, 2004, income tax benefits and net income increased in the amount of \$645,600 due to the revised projection of the future utilization of net operating loss carry forwards.

(8) LEGAL PROCEEDINGS

The Company's Universal Supply Group, Inc. subsidiary is a New York corporation ("USG"). In June 1999, USG acquired substantially all of the assets of Universal Engineering Co., Inc. and Universal Supply Group, Inc., a New Jersey corporation, including its name. The name of Universal Supply Group, Inc. (the selling corporation) was subsequently changed to Hilco, Inc. In 1998, Hilco, Inc. acquired the assets of Amber Supply Co., Inc., previously known as Amber Oil Burner Supply Co., Inc. Universal Engineering Co., Inc., Amber Supply Co., Inc., Amber Oil Burner Supply Co., Inc. and Hilco are referred to as the "Predecessors." The majority

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

shareholders of the Predecessors are John A. Hildebrandt and Paul Hildebrandt. Paul Hildebrandt is a director of the Company.

-10-

USG has been joined as a defendant with Predecessors and many other companies in numerous product liability lawsuits brought in the Superior Court of New Jersey (Middlesex County) that allege injury due to asbestos. These actions have been managed by Predecessors' historic product liability insurance carriers, and all claims, including all defense and settlement costs, to date have been covered and paid by those carriers. John A. Hildebrandt, Paul Hildebrandt and the Predecessors have also indemnified USG against all asbestos claims. The asbestos claims that have been filed to date stem primarily from products sold by the Predecessors prior to 1999 that were manufactured and/or packaged by a third party, which allegedly contained asbestos. The Company does not believe that it will be materially adversely affected by these lawsuits.

### 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, 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 of reported assets, 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.

-11-

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

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 service charge may be applied to receivables that are past due. These charges are included as other income when collected. 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:

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.

### DEFERRED INCOME TAX ASSET

The Company's deferred income tax asset represents certain future tax benefits related to the expected utilization of net operating loss carry forwards. The Company records a valuation allowance against any portion of the deferred income tax asset when it believes, based on the weight of available evidence, it is more likely than not that some portion of the deferred tax asset will not be realized. Events which incurred during the

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

quarter ended September 30, 2004 has caused management to change its valuation allowance related to the realizability of the deferred tax asset.

As of December 31, 2003 gross deferred tax assets in the amount of \$12,363,783 were reduced by a valuation allowance in the amount of \$11,942,383. Such valuation allowance had been reduced by \$792,469 during the year ending December 31, 2003, to reflect management's then assessment of the likelihood of utilizing net operating losses in the future, based upon improved results of operations during 2003 and upon projections of future taxable income.

In July 2004, the Company entered into a new financing agreement along with two private placements. The combination of the private placements and debt financing provided an additional \$4,050,000 in liquidity. It is management's opinion that this additional liquidity will allow the Company to expand inventory levels while taking advantage of purchase discounts and programs. Management believes that this will ultimately result in increased revenues and gross margin percentages. Therefore, management has adjusted its future income projections as a result of these events.

At September 30, 2004 gross deferred tax assets in the amount of \$12,143,273 have been reduced by a valuation allowance in the amount of \$11,076,273. Such valuation allowance includes a reduction of \$645,600 during the three months ended September 30, 2004 based upon its adjustment of its future income and taxable income projections and, accordingly, its reassessment of the likelihood of utilizing net operating loss carry forwards in the future. Management's reassessment is based upon its belief that the events set forth in the preceding paragraph will ultimately result in increased revenues and gross margins.

During the three and nine months periods ended September 30, 2004, income tax benefits and net income increased in the amount of \$645,600 due to the revised projection of the future utilization of net operating loss carry forwards.

### 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 September 30, 2004 and 2003

The Company reported net income of \$839,082 for the third quarter of 2004, as compared to net income of \$325,659 in the third quarter of 2003.

-13-

Sales for the quarter ended September 30, 2004 increased \$4.86 million, or 43.0%, compared to the same period in 2003. The increase in sales is primarily related to the September 30, 2003, RAL acquisition, and the 2003 opening of two new locations, under the name of American/Universal Supply, Inc., which together accounted for \$4.53 million in sales. Existing location sales increased 7.9% in same quarter, mostly attributable to increased market penetration. Simultaneously, gross margin dollars increased by \$1.51 million, or 46.8%,

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

substantially in line with the increase in sales as previously stated. Gross margins, expressed as a percentage of sales, increased from 28.5% in 2003 to 29.2% in 2004, primarily due to the sales of high-end plumbing fixtures related to the RAL acquisition, and more effective purchasing practices.

Selling, general and administrative expenses, and costs of operations increased \$1.33 million, or 47.0%, primarily due to the inclusion of operating expenses related to RAL and American/Universal, establishing a new location, as well as higher insurance costs. Other cost increases were in proportion to increased sales. The change in selling, general and administrative costs expressed as a percentage of sales increased to 25.8% from 25.1%, in the same period in 2003, related to the increased costs associated with the start-up of American/Universal and the integration of the September 30, 2003 acquisition of RAL. Included in selling, general, and administrative expenses for the 2004 quarter is a non-cash charge of \$33,960 for stock based compensation.

Operating income in the third quarter ended September 30, 2004 increased \$171,052, or 44.7%, compared to the same period in 2003. The increase in operating income was primarily driven by increased sales related to the RAL acquisition, the increased business contributed by American/Universal and increased market penetration.

Other income for the same period in the year 2003 included \$91,885 from extinguishment of certain notes payable. There was no similar income in the 2004 quarter.

Interest expense for the quarter ended September 30, 2004 increased by \$100,281, or 67.2%, compared to the same period in 2003. This is primarily due to increased borrowings during the quarter to support the increased inventory and accounts receivable, related to the increased sales from RAL and American/Universal, offset in part by the lower interest rate related to the company's refinancing of its asset based loan with Wells Fargo Business Credit Inc. and the debt incurred by the private placement dated July 29, 2004.

The Company recorded a net federal tax benefit of \$516,000 for the third quarter of 2004 in order to recognize the expected utilization of available operating loss carry forwards, compared to none in the 2003 quarter. In addition, the Company recorded a state tax provision of \$39,649 for the three months ended September 30, 2004 compared to \$42,801 for the three months ended September 30, 2003.

### Results of Operations - Nine Months Ended September 30, 2004 and 2003

The Company reported net income of \$1,203,337 for the nine months of 2004, as compared to net income of \$437,394 in the nine months of 2003.

-14-

Sales for the nine months ended September 30, 2004 increased \$14.49 million, or 47.7%, compared to the same period in 2003. The increase in sales is primarily related to the inclusion of sales from the September 30, 2003 RAL acquisition, and the 2003 opening of two new locations, under the name of American/Universal Supply, Inc., which together accounted for \$11.70 million in sales. Existing location sales increased 11.2% in same period, mostly attributable to increased market penetration. Simultaneously, gross margin dollars increased by \$4.65 million, or 53.5%, substantially in line with the increase in sales as previously stated. Gross margins, expressed as a percentage of sales, increased from 28.6% in 2003 to 29.7% in 2004, primarily due to the sales of high-end

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

plumbing fixtures related to the RAL acquisition, and more effective purchasing practices.

The companies' selling, general and administrative expenses, and costs of operations increased \$4.21 million, or 52.0%, primarily due to the inclusion of operating expenses related to RAL and American/Universal, establishing a new location, as well as higher insurance costs. Other cost increases were in proportion to increased sales. The change in selling, general and administrative costs expressed as a percentage of sales increased to 27.4% from 26.7%, for the same period in 2003, mainly from the increased costs associated with the start-up of American/Universal and the integration of the September 30, 2003 acquisition of RAL. Included in the selling, general and administrative expenses for the nine months ending September 30, 2004 is a non-cash charge of \$84,900 for stock based compensation.

Operating income for the nine months ended September 30, 2004 increased \$439,591, or 74.4%, compared to the same period in 2003. The increase in operating income was primarily driven by increased sales related to the RAL acquisition; the increased business contributed by American/Universal and increased market penetration.

Interest expense for the nine months ended September 30, 2004 increased by \$174,909, or 39.1%, compared to the same period in 2003. This is primarily due to increased borrowings during the period to support the increased inventory and accounts receivable related to the increased sales from RAL and American/Universal, offset in part by the lower interest rate related to the company's refinancing of its asset based loan with Wells Fargo Business Credit Inc. and the debt incurred by the private placement dated July 29, 2004.

The Company included \$91,885 as income from extinguishment of certain notes payable in the 2003 period. There was no similar income in 2004.

The Company recorded a net federal tax benefit of \$645,600 for the nine months ended September 30, 2004 in order to recognize the expected utilization of available operating loss carry forwards, compared to a net federal tax benefit of \$ 91,371 in the 2003 period. In addition, the Company recorded a state tax provision of \$90,822 for the nine months ended September 30, 2004 compared to \$72,208 for the nine months ended September 30, 2003.

The following table summarizes information derived from the Company's condensed consolidated statements of income expressed as a percentage of revenue for the quarter and nine months ended September 30, 2004 and 2003:

-15-

	Nine Months		Quarter	
	Ended September 30,		Ended September 30,	
	2004	2003	2004	2003
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	70.3	71.4	70.8	71.5
Gross profit	29.7	28.6	29.2	28.5



## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

Selling, general and administrative expenses, net	27.4	26.7	25.8	25.1
	-----	-----	-----	-----
Operating income	2.3	1.9	3.4	3.4
Interest expense	(1.4)	(1.5)	(1.5)	(1.3)
Other income	0.5	0.9	0.4	1.2
	-----	-----	-----	-----
Income before taxes	1.4	1.3	2.3	3.3
Income tax benefit (expense)	1.3	0.1	2.9	(0.4)
	-----	-----	-----	-----
Net income	2.7	1.4	5.2	2.9
	=====	=====	=====	=====

### Liquidity and Capital Resources

As of September 30, 2004, the Company had \$472,225 in cash and cash equivalents compared with \$342,756 at December 31, 2003.

On July 29, 2004, the Company completed a \$15,000,000 secured loan facility with Wells Fargo Business Credit Inc. consisting of a revolving line of credit including a \$2,000,000 two-year term loan. This represents a \$1,500,000 increase from its previous line of credit. The revolving credit line bears interest at 1/4% below prime, a decrease of 125 basis points from its previous line of credit, and the term loan bears interest at 1/2% above prime, a decrease of 200 basis points from its previous line of credit. The assets of the Company, as well as a pledge of all the outstanding stock of its operating subsidiaries collateralize all loans. The facility contains covenants relating to the financial condition of the Company and its business operations and restricts the payment of dividends and capital expenditures. Availability under the revolving credit line is determined by a percentage of eligible assets as defined in the agreement. The Company used approximately \$12,865,000 of the proceeds of this facility to repay its previous senior lender and will use the balance for additional working capital.

On July 29, 2004, the Company completed a private placement, pursuant to Regulation D of the Securities Act of 1933. The Company raised \$1,050,000 through the issuance of 420,000 shares of common stock at \$1.25 per share and the issuance of \$525,000 of subordinated unsecured convertible notes payable ("Notes"), bearing interest at 11% per annum, payable quarterly, with 50% of the principal payable on the last day of the fourth anniversary and 50% of the principal payable on the last day of the fifth anniversary. The Notes are convertible into 175,000 shares of common stock at \$3.00 per share during the term of the Notes.

On July 30, 2004, the Company completed a private placement with Michael Goldman and Goldman Associates of New York, Inc. pursuant to Regulation D of the Securities Act of 1933. For total consideration of \$1,500,000, the Company issued to Goldman Associates of New York, Inc. 600,000 shares of common stock at \$1.25 per share, a \$750,000 subordinated secured note payable, earning interest at the prime rate, interest payable quarterly, principal payable on December 31, 2008, and warrants to purchase 150,000 shares of common stock at \$3.00 per share

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

expiring December 31, 2008.

Cash flows used by operations were \$3,278,232 during the nine months ended September 30, 2004. Accounts receivable and inventory increased due to an increase in sales in the third quarter of 2004.

Cash flows used in investing activities of \$347,645 during the nine months ended September 30, 2004 were due to the purchases of property and equipment.

The cash flows provided by financing activities of \$3,755,346 included borrowings on the credit facility of \$1,157,112, borrowings on notes payable of \$1,179,017 and the issuance of 1,620,000 shares of common stock for \$1,635,000, of which a portion of the proceeds were used to repurchase 592,730 shares of convertible preferred stock for \$355,638.

At September 30, 2004, amounts outstanding under the Company's then existing credit facility were \$13,389,142 and \$1,432,376 was available to the company based on available collateral. The Company believes that its 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 prime interest rates, as all borrowings under its credit facility at September 30, 2004 bear interest based on that prime rate less 0.25%, except for the \$1.9 million term loan balance, which bears interest at a rate of prime plus 0.5%. In addition, \$750,000 of the Company's notes payable bear interest at the prime rate. A hypothetical 10% adverse change in such rates would decrease the pre-tax income and cash flow by approximately \$67,750 over a one-year period, assuming the borrowing level remains consistent with the outstanding borrowings as of September 30, 2004. The fair value of the borrowings under the credit facility is not affected by changes in market interest rates.

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

-17-

#### (a) Evaluation of Disclosure Controls and Procedures

An evaluation has been carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and the operation of our "disclosure controls and procedures" (as such term is defined in rules 13a-15(e) under the Securities Exchange Act of 1934) as of September 30, 2004 ("Evaluation Date"). Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, the disclosure controls and procedures are reasonably designed and effective to ensure that (i) information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

(ii) such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

-18-

### PART II. OTHER INFORMATION

#### Item 1. Legal Proceedings

The Company's Universal Supply Group, Inc. subsidiary is a New York corporation ("USG"). In June 1999, USG acquired substantially all of the assets of Universal Engineering Co., Inc. and Universal Supply Group, Inc., a New Jersey corporation, including its name. The name of Universal Supply Group, Inc. (the selling corporation) was subsequently changed to Hilco, Inc. In 1998, Hilco, Inc. acquired the assets of Amber Supply Co., Inc., previously known as Amber Oil Burner Supply Co., Inc. Universal Engineering Co., Inc., Amber Supply Co., Inc., Amber Oil Burner Supply Co., Inc. and Hilco are referred to as the "Predecessors." The majority shareholders of the Predecessors are John A. Hildebrandt and Paul Hildebrandt. Paul Hildebrandt is a director of the Company.

USG has been joined as a defendant with Predecessors and many other companies in numerous product liability lawsuits brought in the Superior Court of New Jersey (Middlesex County) that allege injury due to asbestos. These actions have been managed by Predecessors' historic product liability insurance carriers, and all claims, including all defense and settlement costs, to date have been covered and paid by those carriers. John A. Hildebrandt, Paul Hildebrandt and the Predecessors have also indemnified USG against all asbestos claims. The asbestos claims that have been filed to date stem primarily from products sold by the Predecessors prior to 1999 that were manufactured and/or packaged by a third party, which allegedly contained asbestos. The Company does not believe that it will be materially adversely affected by these lawsuits.

#### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

##### Sale of Unregistered Securities:

On July 29, 2004, the Company completed a private placement, pursuant to Regulation D of the Securities Act of 1933. The Company raised \$1,050,000 through the issuance of 420,000 shares of common stock at \$1.25 per share and the issuance of \$525,000 of subordinated unsecured convertible notes payable ("Notes"), bearing interest at 11% per annum, payable quarterly, with 50% of the principal payable on the last day of the fourth anniversary and 50% of the principal payable on the last day of the fifth anniversary. The Notes are convertible to common stock at \$3.00 per share during the term of the Notes.

The following table lists the purchasers of the private placement dated July 29, 2004:

-19-

Name	Amount of Common Shares	Convertible Note	Cash Consideration
----	-----	----	-----
Richard A. Cancelosi	40,000	\$ 50,000	\$ 100,000

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

James Fallon	40,000	\$ 50,000	\$ 100,000
Rita Folger	80,000	\$ 100,000	\$ 200,000
Margret Friedrich	40,000	\$ 50,000	\$ 100,000
Eileen Goldman	20,000	\$ 25,000	\$ 50,000
John A. Hildebrandt	40,000	\$ 50,000	\$ 100,000
Paul H. Hildebrandt	40,000	\$ 50,000	\$ 100,000
William Pagano	80,000	\$ 100,000	\$ 200,000
William Salek	40,000	\$ 50,000	\$ 100,000
	-----	-----	-----
Total	420,000	\$ 525,000	\$1,050,000
	=====	=====	=====

On July 30, 2004, the Company completed a private placement with Michael Goldman and Goldman Associates of New York, Inc. pursuant to Regulation D of the Securities Act of 1933. For total consideration of \$1,500,000, the Company issued to Goldman Associates, Inc. of New York 600,000 shares of common stock at \$1.25 per share, a \$750,000 subordinated secured note payable, earning interest at the prime rate, interest payable quarterly, principal payable on December 31, 2008, and warrants to purchase 150,000 shares of common stock at \$3.00 per share expiring December 31, 2008.

These securities were issued in reliance on the exemption set forth in Section 4(2) of the Act from registration requirements under the Act.

### Item 3. Defaults Upon Senior Securities

Not applicable

### Item 4. Submission Of Matters To A Vote Of Security Holders

(a) Annual Meeting of Shareholders on September 29, 2004

(b) On September 29, 2004, the preferred shareholders elected William Koon, Ronald Miller and Jack Rose as preferred stock directors of the Company, and the common shareholders elected Michael Goldman, Paul Hildebrandt, Bernard Korn, William Pagano, James W. Stewart and Carl L. Sussman as common stock directors. The common and preferred shareholders voted in favor of a resolution appointing Weiser LLP as the independent public accountants for the Company for the fiscal year ending December 31, 2004.

-20-

PROPOSAL	FOR	AGAINST	ABSTAINED	BROKER NON-VOTES
-----	---	-----	-----	-----
For the preferred shareholders to elect William Koon, Ronald Miller and Jack Rose as Preferred Stock directors:				
William Koon	600,305	--	7,888	--
Ronald Miller	598,592	--	9,601	--
Jack Rose	601,089	--	7,104	--

For the common shareholders to elect Michael Goldman, Paul Hildebrandt, Bernard Korn, ,

## Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

William Pagano, James W.  
Stewart and Carl L. Sussman as  
Common Stock directors:

Michael Goldman	3,755,097	--	93,685	--
Paul Hildebrandt	3,755,097	--	93,685	--
Bernard Korn	3,755,077	--	93,705	--
William Pagano	3,755,097	--	93,685	--
James W. Stewart	3,755,097	--	93,685	--
Carl L. Sussman	3,755,549	--	93,233	--

To ratify the selection of  
Weiser LLP as independent  
public accountants of the  
Company for the fiscal year  
ending December 31, 2004

4,452,281	1,171	3,523	--
-----------	-------	-------	----

### Item 5. Other Information

None

### Item 6. Exhibits

- \* 4.1 Form of Private Placement Agreement and Convertible Note
- \* 4.2 Goldman Associates of New York, Inc. Agreement
- \* 4.3 Goldman Associates of New York, Inc. Note
- \* 4.4 Goldman Associates of New York, Inc. Warrant Agreement
- \*\* 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.
- \* Incorporated by reference to exhibits filed with the Company's Form 10-Q filed with the Securities and Exchange Commission on August 16, 2004.
- \*\* Filed herewith

### 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.

Edgar Filing: COLONIAL COMMERCIAL CORP - Form 10-Q

Dated: November 15, 2004

COLONIAL COMMERCIAL CORP.

/s/ Bernard Korn  
-----

Bernard Korn,  
Chairman of the Board and President

/s/ William Salek  
-----

William Salek  
Chief Financial Officer

-22-