

SUNAIR SERVICES CORP

Form 10-Q

May 15, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

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

**For the quarterly period ended March 31, 2008**

**OR**

**○ TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission file number I-4334**

**SUNAIR SERVICES CORPORATION**

*(Exact name of Registrant as specified in its charter)*

Florida

59-0780772

*(State or other jurisdiction of incorporation or organization)*

*(I.R.S. Employer Identification No.)*

595 South Federal Highway, Suite 500  
Boca Raton, Florida

33432

*(Address of principal executive offices)*

*(Zip Code)*

(561) 208-7400

*(Registrant's telephone number, including area code)*

None

*(Former name, former address and former fiscal year, if changed since last report)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☐ No ○

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ○ Accelerated filer ○ Non-accelerated filer ○ Smaller reporting company ☐  
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ○ No ☐

As of 4/30/08, the Registrant had 13,091,088 shares outstanding of common stock.

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**SUNAIR SERVICES CORPORATION AND SUBSIDIARIES  
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**PART I**  
**FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**SUNAIR SERVICES CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**AS OF MARCH 31, 2008 AND SEPTEMBER 30, 2007**  
**(UNAUDITED)**

ASSETS	March 31, 2008	September 30, 2007
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 3,276,604	\$ 2,781,838
Accounts receivable, net	4,768,613	3,481,064
Inventories, net	2,060,048	1,826,636
Prepaid and other current assets	1,762,752	2,185,909
<b>Total Current Assets</b>	<b>11,868,017</b>	<b>10,275,447</b>
<b>PROPERTY, PLANT, AND EQUIPMENT, net</b>	<b>2,029,081</b>	<b>2,118,552</b>
<b>OTHER ASSETS:</b>		
Note receivable	2,000,000	2,000,000
Software costs, net	271,104	359,375
Customer list, net	9,318,905	10,958,234
Goodwill	62,112,528	60,675,353
Other assets	409,103	390,294
<b>Total Other Assets</b>	<b>74,111,640</b>	<b>74,383,256</b>
<b>TOTAL ASSETS</b>	<b>\$ 88,008,738</b>	<b>\$ 86,777,255</b>

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

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**SUNAIR SERVICES CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**AS OF MARCH 31, 2008 AND SEPTEMBER 30, 2007**  
**(UNAUDITED)**

	<b>March 31, 2008</b>	<b>September 30, 2007</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 2,191,722	\$ 2,346,395
Accrued expenses	3,917,539	4,263,674
Unearned revenues	1,003,036	952,417
Customer deposits	3,562,953	3,166,264
Notes payable and capital leases, current portion	1,838,327	409,029
<b>Total Current Liabilities</b>	<b>12,513,577</b>	<b>11,137,779</b>
<b>LONG TERM LIABILITIES:</b>		
Notes payable and capital leases, net of current portion	4,635,520	5,545,456
Note payable -related party	5,000,000	5,000,000
Revolving line of credit	10,532,796	6,732,796
<b>Total Long Term Liabilities</b>	<b>20,168,316</b>	<b>17,278,252</b>
<b>TOTAL LIABILITIES</b>	<b>32,681,893</b>	<b>28,416,031</b>
<b>COMMITMENTS &amp; CONTINGENCIES</b>		
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock, no par value, 8,000,000 shares authorized, none issued and outstanding		
Common stock, \$.10 par value, 100,000,000 shares authorized, 13,091,088 shares issued and outstanding at March 31, 2008 and September 30, 2007, respectively	1,309,110	1,309,110
Additional paid-in capital	52,581,524	52,378,437
Retained earnings	1,403,998	4,585,007
Accumulated other comprehensive gain cumulative translation adjustment	32,213	88,670
<b>Total Stockholders Equity</b>	<b>55,326,845</b>	<b>58,361,224</b>

<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	\$ 88,008,738	\$ 86,777,255
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The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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**SUNAIR SERVICES CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE SIX MONTHS ENDED MARCH 31, 2008 AND 2007**  
**(UNAUDITED)**

	<b>2008</b>	<b>2007</b>
<b>SALES</b>		
Lawn and pest control services sales	\$ 27,647,194	\$ 25,990,136
Telephone communications sales	5,049,233	5,875,549
<b>Total sales</b>	<b>32,696,427</b>	<b>31,865,685</b>
<b>COST OF SALES</b>		
Lawn and pest control services cost of sales	10,425,089	9,319,837
Telephone communications cost of sales	2,338,867	3,219,253
<b>Total cost of sales</b>	<b>12,763,956</b>	<b>12,539,090</b>
<b>GROSS PROFIT</b>	<b>19,932,471</b>	<b>19,326,595</b>
<b>SELLING, GENERAL AND ADMINISTRATIVE EXPENSES</b>	<b>22,462,331</b>	<b>19,982,156</b>
<b>LOSS FROM OPERATIONS</b>	<b>(2,529,860)</b>	<b>(655,561)</b>
<b>OTHER INCOME (EXPENSES):</b>		
Interest income	122,331	119,418
Interest expense	(728,140)	(675,713)
(Loss) gain on disposal of assets	(6,157)	10,518
<b>Total Other Income (Expenses)</b>	<b>(611,966)</b>	<b>(545,777)</b>
<b>LOSS FROM OPERATIONS BEFORE INCOME TAXES</b>	<b>(3,141,826)</b>	<b>(1,201,338)</b>
<b>INCOME TAX (PROVISION) BENEFIT</b>	<b>(39,183)</b>	<b>269,991</b>
<b>LOSS FROM CONTINUING OPERATIONS</b>	<b>(3,181,009)</b>	<b>(931,347)</b>
<b>INCOME FROM DISCONTINUED OPERATIONS, NET OF INCOME TAX PROVISION OF \$0 and \$562,933 IN 2008 and 2007, RESPECTIVELY</b>		<b>1,312,060</b>
<b>NET (LOSS) INCOME</b>	<b>\$ (3,181,009)</b>	<b>\$ 380,713</b>

<b>BASIC AND DILUTED (LOSS) INCOME PER SHARE:</b>		
<b>CONTINUING OPERATIONS</b>	\$ (0.24)	\$ (0.07)
<b>DISCONTINUED OPERATIONS</b>	\$	\$ 0.10
<b>NET (LOSS) INCOME</b>	\$ (0.24)	\$ 0.03
<b>WEIGHTED AVERAGE SHARES OUTSTANDING:</b>		
<b>BASIC and DILUTED</b>	13,091,088	13,041,634

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

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**SUNAIR SERVICES CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2008 AND 2007**  
**(UNAUDITED)**

	<b>2008</b>	<b>2007</b>
<b>SALES</b>		
Lawn and pest control services sales	\$ 14,198,297	\$ 13,601,619
Telephone communications sales	2,578,029	3,316,464
<b>Total sales</b>	<b>16,776,326</b>	<b>16,918,083</b>
<b>COST OF SALES</b>		
Lawn and pest control services cost of sales	5,458,133	4,758,071
Telephone communications cost of sales	1,186,723	1,732,989
<b>Total cost of sales</b>	<b>6,644,856</b>	<b>6,491,060</b>
<b>GROSS PROFIT</b>	<b>10,131,470</b>	<b>10,427,023</b>
<b>SELLING, GENERAL AND ADMINISTRATIVE EXPENSES</b>	<b>10,868,570</b>	<b>10,345,084</b>
<b>(LOSS) INCOME FROM OPERATIONS</b>	<b>(737,100)</b>	<b>81,939</b>
<b>OTHER INCOME (EXPENSES):</b>		
Interest income	68,427	51,644
Interest expense	(348,513)	(387,390)
(Loss) gain on disposal of assets	(10,827)	32,224
<b>Total Other Income (Expenses)</b>	<b>(290,913)</b>	<b>(303,522)</b>
<b>LOSS FROM OPERATIONS BEFORE INCOME TAXES</b>	<b>(1,028,013)</b>	<b>(221,583)</b>
<b>INCOME TAX (PROVISION)</b>	<b>(39,183)</b>	<b>(47,312)</b>
<b>(LOSS) FROM CONTINUING OPERATIONS</b>	<b>(1,067,196)</b>	<b>(268,895)</b>
<b>INCOME FROM DISCONTINUED OPERATIONS, NET OF INCOME TAX BENEFIT OF \$0 and \$206,770 IN 2008 and 2007, RESPECTIVELY</b>		<b>49,917</b>
<b>NET (LOSS)</b>	<b>\$ (1,067,196)</b>	<b>\$ (218,978)</b>

**BASIC AND DILUTED (LOSS) PER SHARE:**

<b>CONTINUING OPERATIONS</b>	\$ (0.08)	\$ (0.02)
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<b>DISCONTINUED OPERATIONS</b>	\$	\$ 0.00
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<b>NET (LOSS) INCOME</b>	\$ (0.08)	\$ (0.02)
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**WEIGHTED AVERAGE SHARES OUTSTANDING:**

<b>BASIC and DILUTED</b>	13,091,088	13,066,578
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The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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**SUNAIR SERVICES CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**  
**AND COMPREHENSIVE (LOSS) INCOME**  
**FOR THE SIX MONTHS ENDED MARCH 31, 2008**  
**(UNAUDITED)**

	Common Stock		Additional	Retained	Accumulated	Total
	Shares	Amount	Paid-in Capital	Earnings	Other Comprehensive Income (Loss)	Stockholders Equity
Balance at September 30, 2007	13,091,088	\$ 1,309,110	\$ 52,378,437	\$ 4,585,007	\$ 88,670	\$ 58,361,224
Comprehensive income:						
Net (loss)				(3,181,009)		(3,181,009)
Currency translation adjustment					(56,457)	(56,457)
Comprehensive (loss)				(3,181,009)	(56,457)	(3,237,466)
Share-based compensation			203,087			203,087
Balance at March 31, 2008	13,091,088	\$ 1,309,110	\$ 52,581,524	\$ 1,403,998	\$ 32,213	\$ 55,326,845

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

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**SUNAIR SERVICES CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX MONTHS ENDED MARCH 31, 2008 AND 2007**  
**(UNAUDITED)**

	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) income	\$ (3,181,009)	\$ 380,713
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation	454,946	470,443
Amortization	1,952,805	1,159,023
Deferred taxes		269,100
Bad debt reserve		5,747
Inventory reserve	(423,193)	77,962
Loss (gain) on sale of assets	6,157	(2,380,398)
Stock-based compensation expense	203,087	240,808
Stock issued for services rendered		45,000
(Increase) decrease in assets:		
Accounts receivable	(1,214,763)	(1,644,822)
Income tax receivable		23,842
Inventories	202,980	(351,078)
Prepaid and other current assets	400,471	(411,620)
Other assets	3,875	393,372
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	(758,450)	2,327,681
Unearned revenue	50,619	67,321
Income taxes payable		(1,057)
Customer deposits	392,892	134,091
<b>Net Cash (Used In) Provided By Operating Activities</b>	<b>(1,909,583)</b>	<b>806,128</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property, plant, and equipment	(289,352)	(202,470)
Software development costs		(162,018)
Cash paid for business acquisitions	(1,000,000)	(1,518,432)
Net proceeds from sale of assets	30,796	2,531,963
<b>Net Cash (Used In) Provided by Investing Activities</b>	<b>(1,258,556)</b>	<b>649,043</b>

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

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**SUNAIR SERVICES CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX MONTHS ENDED MARCH 31, 2008 AND 2007**  
**(UNAUDITED)**

	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of line of credit (net)		(900,000)
Proceeds from line of credit	3,800,000	
Repayment of notes payable and capital leases	(80,638)	(56,707)
<b>Net Cash Provided By (Used In) Financing Activities</b>	<b>3,719,362</b>	<b>(956,707)</b>
Effect of exchange rate fluctuations on cash	(56,457)	99,867
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>494,766</b>	<b>598,331</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>2,781,838</b>	<b>1,601,110</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 3,276,604</b>	<b>\$ 2,199,441</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for income taxes	\$	\$
Cash paid during the period for interest	\$ 676,228	\$ 549,113
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Common stock issued in acquisition	\$	\$ 300,000
Debt incurred in acquisitions	\$ 600,000	\$ 1,500,000

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

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**SUNAIR SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**1. Basis of Consolidated Financial Statement Presentation**

The accompanying unaudited condensed consolidated financial statements include the accounts of Sunair Services Corporation and its subsidiaries (the Company), required to be consolidated in accordance with U.S. generally accepted accounting principles (GAAP). The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the accounting policies described in the September 30, 2007 Annual Report on Form 10-K except for the accounting policy relating to accounting for uncertainty in income taxes, and should be read in conjunction with the consolidated financial statements and notes thereto.

The unaudited condensed consolidated financial statements for the six and three months ended March 31, 2008 and 2007 included herein have been prepared in accordance with the instructions for Form 10-Q under the Securities Exchange Act of 1934, as amended, and Article 8 of Regulation S-X under the Securities Act of 1933, as amended. Certain information and footnote disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations relating to interim financial statements.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain only normal recurring adjustments necessary to present fairly the Company's financial position as of March 31, 2008, and the results of its operations and cash flows for the six and three months ended March 31, 2008 and 2007. Operating results for the six months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2008.

**2. Summary of Significant Accounting Policies**

**Income taxes**

Effective October 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires that the Company determine whether the benefits of the Company's tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. The provisions of FIN 48 also provide guidance on de-recognition, classification, interest and penalties, accounting in interim periods, and disclosure. The Company did not have any unrecognized tax benefits and there was no effect on the financial condition or results of operations as a result of implementing FIN 48. The Company does not have any interest and penalties in the statement of operations for the six and three months ended March 31, 2008. The tax years 2004-2007 remain subject to examination by major tax jurisdictions.

**Reclassification**

Certain reclassifications of amounts previously reported have been made to the accompanying consolidated financial statements in order to maintain consistency and comparability between periods presented.

In August 2007, the Company sold all the issued and outstanding common stock of Percipia, Inc. (Percipia). For purposes of comparability, the results of these operations have been reclassified from continuing operations to discontinued operations for the six months ended March 31, 2007 presented in the accompanying condensed consolidated statements of operations. See Note 10- Discontinued Operations.

**Recent Accounting Pronouncements**

In December 2007, the FASB issued SFAS No. 141 (revised 2007) *Business Combinations* (FASB No. 141(R)). FASB No. 141(R) retains the fundamental requirements of the original pronouncement requiring that the purchase method be used for all business combinations. FASB No. 141(R) defines the acquirer as the entity that obtains control of one or more businesses in the business combination, establishes the acquisition date as the date that the acquirer achieves control and requires the acquirer to recognize the assets acquired, liabilities assumed and any non-controlling interest at their fair values as of the acquisition date. FASB No. 141(R) also requires that acquisition-related costs be recognized separately from the acquisition. FASB No. 141(R) is effective for the Company for fiscal 2010. The



Company is currently assessing the impact of FASB No. 141(R) on its consolidated financial position and results of operations.

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In December 2007, the FASB issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51 ( FASB No. 160 )*. The objective of FASB No. 160 is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This Statement applies to all entities that prepare consolidated financial statements, except not-for-profit organizations. FASB No. 160 amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also amends certain of ARB 51's consolidation procedures for consistency with the requirements of FASB No. 141 (R). This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 (that is, January 1, 2009, for entities with calendar year-ends). Earlier adoption is prohibited. The effective date of this Statement is the same as that of the related Statement 141(R). FASB No. 160 will be effective for the Company's fiscal year 2010. This Statement shall be applied prospectively as of the beginning of the fiscal year in which this Statement is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements shall be applied retrospectively for all periods presented. The Company is currently assessing the impact of FASB No. 160 on its consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – including an amendment of FASB Statement No. 115 ( FASB No. 159 )*. FASB No. 159 gives the Company the irrevocable option to carry most financial assets and liabilities at fair value, with changes in fair value recognized in earnings. FASB No. 159 is effective for the Company's 2009 fiscal year, although early adoption is permitted. The Company is currently assessing the impact of FASB No. 159 on its consolidated financial statements.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements ( FASB No. 157 )*. FASB No. 157 provides a common definition of fair value and establishes a framework to make the measurement of fair value in generally accepted accounting principles more consistent and comparable. FASB No. 157 also requires expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. On December 14, 2007, the FASB issued proposed FASB Staff Position No. FAS 157-b, *Effective Date of FASB No. 157 ( Proposed FSP)*. The Proposed FSP would amend FASB No. 157, to delay the effective date of FASB No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (that is, at least annually). The Proposed FSP defers the effective date of FASB No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of the Proposed FSP. FASB No. 157 will be effective for the Company's 2010 fiscal year, although early adoption is permitted. The Company is currently assessing the potential effect of FASB No. 157 on its consolidated financial statements.

**3. Acquisitions****Acquisition of Marshall Pest Control of SW FL, Inc.**

On October 2, 2007, Middleton Pest Control, Inc. ( Middleton ) acquired substantially all the assets of Marshall Pest Control of SW FL, Inc. ( Marshall ), a lawn and pest control services company located in Naples, Florida for \$1.6 million, consisting of \$1.0 million in cash and \$600,000 in the form of a promissory note. In addition, the Company incurred working capital adjustments and transaction costs of approximately \$0.3 million.

The following table sets forth the allocation of the purchase price to Marshall tangible and intangible assets acquired and liabilities assumed as of October 2, 2007:

Goodwill	\$ 1,487,775
Customer list	225,204
Accounts receivable	68,989
Inventory	13,199
Fixed assets	62,475
Total	\$ 1,857,642



**Table of Contents****Acquisition of Archer Exterminators, Inc. ( Archer )**

On November 30, 2006, Middleton entered into an Asset Purchase Agreement to acquire substantially all of the assets of Archer for \$3,300,000 consisting of \$1,500,000 cash, \$1,500,000 in the form of a subordinated promissory note and 73,529 shares of the Company's common stock valued at \$300,000. In addition, the Company incurred working capital adjustments and transaction costs totaling \$0.1 million. The shares were issued in January, 2007.

**Acquisition of Valentine's Indoor Pest Management, Inc. ( Valentine )**

On February 8, 2007, Middleton acquired substantially all the assets of Valentine, headquartered in St. Cloud, Florida for approximately \$43,400, consisting of \$18,432 in cash and \$25,000 in the form of a promissory note.

**Acquisition of David Burke, Inc. D/B/A Florida Exterminating ( Florida Exterminating )**

On April 30, 2007, Middleton acquired substantially all the assets of Florida Exterminating, a pest control company headquartered in Tampa, Florida for approximately \$815,000 consisting of \$580,000 in cash and \$235,000 in the form of a promissory note.

**Acquisition of Summer Rain Fertilization Company ( Summer Rain )**

On May 31, 2007, Middleton acquired substantially all the assets of Summer Rain, a lawn care services company headquartered in Margate, Florida for approximately \$1.0 million, consisting of \$500,000 in cash and \$500,000 in the form of a promissory note.

**Acquisition of Howell Environmental, Inc. ( Howell )**

On August 21, 2007, Middleton acquired substantially all the assets of Howell, a lawn care and pest control services company located in West Palm Beach, Florida, for approximately \$2.3 million, consisting of \$925,000 in cash and \$1.4 million in the form of a promissory note with \$1.0 million secured by a letter of credit.

**Acquisition of Longboat Key Pest Control, Inc. ( Longboat Key )**

On September 20, 2007, Middleton acquired substantially all of the assets of Longboat Key, a lawn care and pest control services company located in Longboat, Florida for \$1.7 million, consisting of \$1.0 million in cash, \$542,000 in the form of a promissory note and \$158,000 to be paid over a two year period at 50% of the cash collections related to a large commercial customer. The \$158,000 is considered contingent purchase price and will be recorded as part of the purchase price at the time it becomes probable that the contingency will be resolved and payment will be received.

**Purchase Price Allocation**

The following table sets forth the allocation of the purchase price for tangible and intangible assets associated with the above 2007 and 2008 acquisitions and their related acquired assets and liabilities assumed as of March 31, 2008:

Goodwill	\$ 9,344,859
Customer list	2,159,885
Accounts receivable	641,666
Inventory	62,418
Fixed assets	576,424
Prepaid expenses	210,644
Customer deposits	(79,281)
Deferred revenue	(677,539)
 Total	 \$ 12,239,076

**Table of Contents****Pro-Forma Results of Operations**

The following sets forth the Company's results of operations for the six months ended March 31, 2007 as if the acquisitions had taken place on October 1, 2006.

	<b>For the Three Months Ended March 31, 2007</b>	<b>For the Six Months Ended March 31, 2007</b>
Revenues	\$ 18,584,507	\$ 35,590,962
Net income	\$ 205,744	\$ 1,146,631
Net income per share Basic and diluted	\$ 0.02	\$ 0.09

The pro-forma results of operations for the three and six months ended March 31, 2008 are not presented since there was an insignificant difference between pro-forma and actual results for the period as our sole acquisition Marshall was acquired on October 2, 2007.

**4. Note Receivable**

Pursuant to the Asset Purchase Agreement on September 8, 2006 between the Company and Sunair Electronics, LLC formerly known as Sunair Holdings, LLC ( Sunair Holdings ), the Company received a three year subordinated promissory note as partial payment for the sale of substantially all of the assets of Sunair Communications, Inc. ( Sunair Communications ). The \$2.0 million note issued by Sunair Holdings is guaranteed by the members of Sunair Holdings, matures on September 8, 2009 and bears interest at one year London Interbank Offering Rate ( LIBOR ) plus 3% (5.49% at March 31, 2008) which is payable monthly starting on October 1, 2006. Accrued interest income through March 31, 2008, included in prepaid and other current assets in the accompanying condensed consolidated balance sheets amounted to \$57,132. At September 30, 2007 accrued interest income amounted to \$55,560. The Company's former Chief Financial Officer, who also was the former Chief Financial Officer of Sunair Communications, and the Company's former President, who also was the former President of Sunair Communications, are also affiliates of Sunair Holdings.

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**5. Revolving Line of Credit**

The Company has a line of credit with a financial institution collateralized by substantially all of the assets of the Company. The maximum credit limit was \$13.5 million as of March 31, 2008. Interest is compounded daily based upon the LIBOR plus 5.0%. The interest rate at March 31, 2008 was approximately 7.49%. The revolving line of credit has a commitment fee in the amount of .375% per annum on the average daily unused amount of the aggregate revolving committed amount. The outstanding balance on the revolving line of credit at March 31, 2008 and September 30, 2007, respectively, amounted to \$10,532,796 and \$6,732,796. At March 31, 2008, the availability under the revolving line of credit amounted to \$1,967,204 which is net of a \$1.0 million outstanding letter of credit. On May 14, 2007, the Company amended the terms of its credit agreement to extend the maturity date to April 1, 2008 and to reduce the capacity under the revolving line of credit from \$20.0 million to \$16.0 million. This amendment also modified certain financial covenants. The leverage ratio was increased and the consolidated EBITDA requirement was reduced. On August 14, 2007, the Company obtained a subsequent extension of the maturity date on the credit agreement to October 1, 2008.

On February 12, 2008, the Company amended certain terms and conditions of the credit agreement. Among the amended terms and conditions were an extension of the maturity date to January 7, 2009 as well as amendments to the financial covenants relating to consolidated EBITDA, the leverage ratio and the fixed charge coverage ratio, which amendments are effective as of December 31, 2007. As of March 31, 2008, the Company was in compliance with its financial covenants.

**6. Notes Payable**

The Company has a capital lease for certain office equipment. The balance of the capital lease at March 31, 2008 and September 30, 2007, totaled \$14,643 and \$16,353, respectively.

The Company has notes payable with a financial institution for leased office build out costs and computer equipment. The notes bear interest at 5.60% and 5.25% per annum, respectively, payable in monthly installments of principal and interest in the amount of \$3,285 through March 29, 2011 and \$5,795 through September 20, 2008, respectively. Balances at March 31, 2008 and September 30, 2007, totaled \$142,666 and \$192,367, respectively.

The Company has notes payable with financial institutions for automobile loans. Interest rates range from 0% to 9% per annum, payable in monthly installments of principal and interest ranging in the amounts of \$220 to \$687, expiring in various years through 2010. Balances at March 31, 2008 and September 30, 2007, totaled \$39,538 and \$68,765, respectively.

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The Company has notes payable relating to certain acquisitions as described in Note 3- Acquisitions which bear interest at 6% and 7%, with one note payable bearing interest at LIBOR plus 2% per annum (4.49% at March 31, 2008), with interest payable in semi-annual installments ranging in the amounts of \$3,000 to \$49,000 and principal due at maturity. The notes expire in various years through 2011. The note payable balances for the acquisition debt at March 31, 2008 and September 30, 2007, totaled \$6,277,000 and \$5,677,000, respectively.

Interest expense incurred for the notes payable amounted to \$217,528 and \$107,640 for the six and three months ended March 31, 2008, respectively, and \$91,557 and \$54,643 for the six and three months ended March 31, 2007, respectively.

Minimum future principal payments required under the above notes payable as of March 31, 2008, for each of the next five years and in the aggregate are:

2008	\$ 1,838,327
2009	2,056,599
2010	1,435,104
2011	1,143,817
2012	
Thereafter	
	6,473,847
Less: current portion	1,838,327
Long term portion	\$ 4,635,520

**7. Notes Payable-Related Party**

The Company has a \$5,000,000 subordinated note payable to related parties, in connection with the acquisition of Middleton. As of March 31, 2008 these related parties include Charles Steinmetz, the former CEO of Middleton from 1977 through June 2005 and the current CEO, who was appointed to serve as CEO of Middleton again effective January 18, 2008. Mr. Steinmetz was the majority owner of Middleton from 1977 until it was purchased by the Company in June 2005 and has served as a director of the Company since that time. Interest is paid semi-annually at prime (5.25% as of March 31, 2008). The note payable is due in full on June 7, 2010. Interest expense related to this note payable amounted to \$183,835 and \$75,068, for the six and three months ended March 31, 2008, respectively, and \$207,250 and \$102,966 for the six and three months ended March 31, 2007, respectively.

**8. Income Taxes**

The Company did not have an income tax provision or benefit for the six and three months ended March 31, 2008, respectively, as the Company has \$13.5 million of net operating losses carryforwards which expire in 2026 and which are fully reserved. In addition, the Company does not have any net operating loss carrybacks. As a result the Company was unable to recognize an income tax benefit for the three and six months ended March 31, 2008. The income tax provision of \$39,183 for the three months ended March 31, 2008 relates to foreign income taxes incurred by Telecom FM. For the six and three months ended March 31, 2007, the Company had an income tax benefit (provision) of \$269,991 and (\$47,312) for continuing operations, respectively.

**9. Stock Options**

At the annual meeting of shareholders held on February 4, 2005, the shareholders approved the adoption of the Company's 2004 Stock Incentive Plan with an aggregate of 800,000 shares of the Company's unissued common stock, to replace the Company's 2000 Stock Option Plan, which was approved by the Company's shareholders at a shareholders meeting held on January 24, 2000. The 800,000 shares authorized under the 2004 Stock Incentive Plan are reserved for issuance to officers, directors, employees and prospective employees as incentive stock options, non-qualified stock options, restricted stock awards, other equity awards and performance based stock incentives. The option price, numbers of shares and grant date are determined at the discretion of the Company's board of directors or the committee overseeing the 2004 Stock Incentive Plan.

There were 369,000 and 35,000 options granted during the three months ended March 31, 2008 and 2007, respectively.



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Stock options activity for the six months ended March 31, 2008 is as follows:

	<b>Shares</b>	<b>Weighted Avg. Exercise Price</b>	<b>Remaining Life</b>
Balances, beginning of period	585,092	\$ 6.94	
Granted	369,000	\$ 1.76	
Exercised		\$	
Expired/Forfeited	(58,476)	\$ 8.15	
Options outstanding, end of period	895,616	\$ 4.55	6.30
Options exercisable, end of period	443,685	\$ 6.44	5.09
Options available for future grants	111,051		

Included in the 895,616 options outstanding are 206,667 options that were granted outside of the 2004 Stock Incentive Plan.

**Fair Value**

On January 1, 2006, the Company adopted the provisions of FASB No. 123R which requires the Company to recognize expense related to the fair value of stock-based compensation awards. The Company elected the modified prospective transition method as permitted by FASB No. 123R, under which stock-based compensation for the six and three months ended March 31, 2008 and 2007 is based on grant date fair value estimated in accordance with the provisions of FASB No. 123R and compensation expense for all stock-based compensation awards granted subsequent to January 1, 2006, as well as the unvested portion of previously granted awards that remained outstanding as of January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of FASB No. 123R. In addition, options granted to certain members of the board of directors as payment for Board services recorded in accordance with FASB No. 123R and the issuance of restricted stock awards and stock units are also included in stock-based compensation for the six and three months ended March 31, 2008 and 2007. The Company recognizes compensation expense for restricted stock awards and restricted stock units on a straight-line basis over the requisite service period of the award. The Company recorded \$203,087 and \$61,075 of stock-based compensation expense which has been classified as selling, general and administrative expenses for the six and three months ended March 31, 2008, respectively, and \$240,808 and \$23,824 for the six and three months ended March 31, 2007, respectively.

The fair value of stock-based awards was estimated using the Black-Scholes model, on the date of grant, with the following weighted-average assumptions:

	<b>For the Six Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Expected dividend yield		
Expected price volatility	63.76-64.36%	65.21-70.07%
Risk-free interest rate	2.8-3.09%	3.76-4.61%
Expected life of options	4.50-5.25 years	5-8.25 years

The Company's computation of the expected volatility for the six months ended March 31, 2008 and 2007 is based primarily upon historical volatility and the expected term of the option. The Company continues to use the simplified method of determining the expected term provided under SAB 110 as sufficient historical data is not available. The interest rate is based on the U.S. Treasury yield in effect at the time of grant for a period commensurate with the estimated expected life.

As of March 31, 2008, approximately \$811,657 of total unrecognized compensation costs related to non-vested stock options is expected to be recognized over a weighted average period of 2.51 years.



**Table of Contents****10. Discontinued Operations**

On August 1, 2007, the Company sold all the outstanding shares of Percipia, a wholly-owned subsidiary, in our Telephone Communications segment for approximately \$4.0 million in cash, of which \$750,000 was placed in an escrow account pending the resolution of certain tax matters.

On November 20, 2006, the Company closed a transaction to sell the real estate property associated with the previously sold high frequency radio business for \$2.7 million in cash and a recognized gain in the amount of \$2.2 million, \$1.4 million net of income taxes.

The accompanying consolidated condensed statements of operations for the six months presented have been adjusted to classify Percipia as discontinued operations. Selected statements of operations data for the Company's discontinued operations is as follows:

	<b>(dollars in thousands)</b>
	<b>For the Six Months</b>
	<b>Ended</b>
	<b>March 31, 2007</b>
Percipia, Inc. Net loss	\$ (308)
Pre-tax (loss) from discontinued operations	(308)
Income tax benefit	259
(Loss) from discontinued operations, net of income taxes	(49)
Gain on sale of assets from discontinued operations	2,183
Income tax (provision)	(822)
Gain on sale of assets from discontinued operations, net of income taxes	1,361
Income from discontinued operations, net of income taxes	\$ 1,312

**11. Commitments and Contingencies**

The Company leases office space under operating leases expiring in various years through 2012, and vehicles under operating leases expiring in various years through 2014. Certain leases provide for renewal options for periods from one to five years at their fair rental value at the time of renewal. In the normal course of business, operating leases are generally renewed or replaced by other leases. Rent expense and vehicle lease expense was \$1,792,213 and \$954,846 for the six and three months ended March 31, 2008, respectively, and \$1,653,070 and \$834,554 for the six and three months ended March 31, 2007, respectively.

**Litigation**

We are involved in litigation from time to time in the ordinary course of our business. Except for the litigation described below, we do not believe that any litigation in which we are currently involved, individually or in the aggregate, is material to our financial condition or results of operations.

In October 2007, the Company filed a lawsuit in the Circuit Court for the Ninth Judicial Circuit in the State of Florida against a number of former employees of Middleton for violation of their non-compete agreements. In addition, certain of these former employees pursued and hired away employees of Middleton which is also a violation of the existing employee non-compete agreements. The Company is seeking injunctive relief and damages. In October 2007, the Company also filed a lawsuit against a competitor for tortious interference as they hired these former employees knowing that they were in violation of the Company's non-compete agreement. This matter was settled during the three months ended March 31, 2008 for an immaterial amount.



**Table of Contents****12. Goodwill and Intangible Assets**

Goodwill and intangible assets consist of the following at March 31, 2008 and September 30, 2007:

	<b>Goodwill</b>	<b>Customer Lists</b>	<b>Total</b>
Ending balance, September 30, 2007	\$ 60,675,353	\$ 10,958,234	\$ 71,633,587
Acquisition of businesses	1,487,775	225,204	1,712,979
Purchase price adjustment	(50,600)		(50,600)
	62,112,528	11,183,438	73,295,966
Less amortization expense		(1,864,533)	(1,864,533)
Ending balance, March 31, 2008	\$ 62,112,528	\$ 9,318,905	\$ 71,431,433

The table below presents the weighted average life in years of the Company's intangible assets.

	<b>2008</b>	<b>2007</b>
Goodwill	(a)	(a)
Customer lists (b)	5	8
Weighted average	5	8

(a) Goodwill is not amortized but, along with all other intangible assets, is reviewed for possible impairment each year at September 30th or when indicators of impairment exist.

(b) Change in estimated useful life for customer lists during the fourth quarter of 2007.

The table below reflects the estimated aggregate customer account amortization for each of the five succeeding years of the Company's existing customer account base as of March 31, 2008:

	<b>Aggregate Amortization Expense</b>
2008	\$3,724,403
2009	3,724,403
2010	1,426,743
2011	384,060
2012	59,296
Total Aggregate Amortization Expense	\$9,318,905

**13. Net Income (Loss) Per Share**

Basic net income (loss) per share is computed using the weighted average number of shares outstanding during the period. Due to the Company's losses from continuing operations, dilutive potential common shares in the form of warrants were excluded from the computation of diluted loss per share, as inclusion would be anti-dilutive for the periods presented.

**Table of Contents****14. Segment and Geographic Information**

The Company manages its business and has segregated its activities into two business segments; (i) Pest control, lawn and shrub care, subterranean and drywood termite control and mosquito reduction services and (ii) installation and maintenance of telephone communication systems.

Certain financial information for each segment is provided below as of March 31, 2008 and September 30, 2007, and for the six months ended March 31, 2008 and 2007:

	<b>For the Six Months Ended March</b>	
	<b>31,</b>	
	<b>2008</b>	<b>2007</b>
Net revenues:		
Lawn and pest control services	\$ 27,647,194	\$ 25,990,136
Telephone communications	5,049,233	5,875,549
Total net revenues	\$ 32,696,427	\$ 31,865,685
Operating income (loss):		
Lawn and pest control services	\$ 1,523,281	\$ 2,555,710
Telephone communications	332,231	228,404
Unallocated home office expenses	(4,385,372)	(3,439,675)
Total operating loss	\$ (2,529,860)	\$ (655,561)
	<b>March 31,</b>	<b>September</b>
	<b>2008</b>	<b>30,</b>
		<b>2007</b>
Identifiable property plant and equipment:		
Lawn and pest control services	\$ 1,988,340	\$ 2,062,451
Telephone communications	40,741	56,101
Total identifiable property plant and equipment	\$ 2,029,081	\$ 2,118,552

The Company operates worldwide, primarily in North America. Middleton operates entirely within the State of Florida and Telecom FM operates primarily in Spain, the United Kingdom and Italy.

**15. Related Parties**

The Company pays management fees to RPC Financial Advisors, LLC ( RPC ), a related party. On January 7, 2008, the Company entered into a management services agreement ( Management Services Agreement or the Amended Management Services Agreement ) with RPC, which supersedes and replaces the management services agreement (the Previous Management Services Agreement ) dated February 8, 2005, as amended, between the Company and RPC. Pursuant to the Amended Management Services Agreement, the Company provided RPC with notice that the Previous Management Services Agreement would not be renewed and that the Amended Management Services Agreement would be effective as of February 8, 2008.

The Amended Management Services Agreement is for a term of three years which commenced on February 8, 2008 and expires on February 7, 2011. The Company will pay RPC a monthly management fee equal to one (1%) of the monthly gross revenues of the Company, which will be payable monthly based on the average monthly revenues of the preceding quarter. RPC will also receive a transaction fee of up to 2% of the Aggregate Consideration received by the Company in a Transaction (as such capitalized terms are defined in the Management Services Agreement). Pursuant to the Management Services Agreement, RPC will provide the Company with services similar to those

provided in the Previous Management Services Agreement. After the initial term of three years, the Management Services Agreement will automatically renew for successive one year terms, unless either RPC or the Company terminates the agreement upon 30 days notice. Management fees for the six and three months ended March 31, 2008 totaled \$689,470 and \$298,845, respectively, and \$782,394 and \$390,625 for the six and three months ended March 31 2007, respectively.

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The Company issued a note payable to related parties in connection with the acquisition of Middleton, as discussed in Note 7-Note Payable-Related Party.

The Company received a note receivable from former related parties through the sale of Sunair Communications, the high frequency radio segment, as more fully described in Note 4-Note Receivable.

**Item 2. Management's Discussion And Analysis of Financial Condition and Results of Operations**

**Cautionary Statement Regarding Forward Looking Information:**

Some of the statements in this quarterly report, including those that contain the words anticipate, believe, plan, estimate, expect, should, intend and other similar expressions, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Those forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements or those of our industry to be materially different from any future results, performance or achievements expressed or implied by those forward-looking statements. Among the factors that could cause actual results, performance or achievement to differ materially from those described or implied in the forward-looking statements are general economic conditions, competition, potential technology changes, changes in or the lack of anticipated changes in the regulatory environment in various countries, the risks inherent in new product and service introductions and the entry into new geographic markets and other factors included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2007 filed with the Securities and Exchange Commission (the SEC) on January 15, 2008 and other filings with the SEC. Copies of our SEC filings are available from the SEC or may be obtained upon request from us. We do not undertake any obligation to update the information contained herein, which speaks only as of this date.

**Company Overview**

Sunair Services Corporation (the Company we or us) is a Florida corporation organized in 1956. We changed our corporate name from Sunair Electronics, Inc. to Sunair Services Corporation in November of 2005. Previously, we operated through two business segments: Telephone Communications and High Frequency Radio. In June 2005 with the acquisition of Middleton Pest Control, Inc. (Middleton) we embarked on a new strategy to become a leading regional provider of lawn and pest control services focusing mainly on residential customers.

In order to execute our strategy, we shifted our focus to the Lawn and Pest Control Services business segment, which resulted in a series of acquisitions and divestitures planned to enable us to shed our legacy businesses (Telephone Communications and High Frequency Radio) and grow our core business, lawn and pest control. We intend to divest ourselves of our remaining telecommunications subsidiary, Telecom FM Limited (Telecom FM), as soon as is practicable. However, we cannot assure you of the timing of such disposition, or the amount of net proceeds we will receive upon such disposition.



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To date the acquisitions and divestitures have been as follows:

**Acquisitions:**

June 2005 we acquired the issued and outstanding stock of Middleton, our platform company, a leading provider of lawn and pest control services in Florida.

July 2005 we acquired substantially all the assets of Four Seasons Lawn and Pest Control, Inc.

December 2005 we acquired substantially all the assets of Spa Creek Services, LLC, D/B/A as Pest Environmental Services, Inc.

January 2006 we acquired substantially all the assets of Par Pest Control, Inc., D/B/A Paragon Termite & Pest Control.

February 2006 we acquired substantially all the assets of Pestec Pest Control, Inc.

March 2006 we acquired substantially all the assets of Ron Fee, Inc.

November 2006 we acquired substantially all the assets of Archer Exterminators, Inc.

February 2007 we acquired substantially all the assets of Valentine s Indoor Pest Management, Inc.

April 2007 we acquired substantially all the assets of David Burke, Inc., D/B/A Florida Exterminating.

May 2007 we acquired substantially all the assets of Summer Rain Fertilization Company.

August 2007 we acquired substantially all the assets of Howell Environmental, Inc.

September 2007 we acquired substantially all the assets of Longboat Key Pest Control, Inc.

October 2007 we acquired substantially all the assets of Marshall Pest Control of SW FL, Inc.

All of these acquisitions of lawn care and pest control companies have been made by Middleton, our platform company, and are being integrated into its operations.

**Dispositions:**

September 2006 we sold substantially all the assets of Sunair Communications Inc., our high frequency radio business.

November 2006 we sold real estate associated with the previously sold high frequency radio business.

August 2007 we sold all the issued and outstanding stock of Percipia, Inc. ( Percipia ), a wholly-owned subsidiary in our telephone communications segment.

**Table of Contents****Results of Operations****Results of Operations for the Three Months Ended March 31, 2008 as Compared to the Three Months Ended March 31, 2007.****Revenue:**

	<b>(dollars in thousands)</b>	
	<b>For the Three Months</b>	
	<b>Ended</b>	
	<b>March 31,</b>	
	<b>2008</b>	<b>2007</b>
Lawn and pest control services	\$ 14,198	\$ 13,602
Telephone communications	2,578	3,316
Total revenue	\$ 16,776	\$ 16,918

***Lawn and Pest Control Services***

Revenue from the lawn and pest control services segment is comprised of lawn, pest control and termite services. Revenue in the segment increased by \$0.6 million or 4.4% for the three months ended March 31, 2008 as compared to the three months ended March 31, 2007. The revenue increase was primarily attributable to the integration of our acquisitions since December 31, 2006.

***Telephone Communications***

Our remaining telephone communications subsidiary, Telecom FM, manufactures and sells least-cost routing devices. Revenue from Telecom FM decreased by \$0.7 million or 22.3% for the three months ended March 31, 2008 as compared to the three months ended March 31, 2007. During the second quarter of fiscal year 2007 Telecom FM received a series of large orders due to a change in legislation. This did not occur in the quarter ended March 31, 2008.

**Cost of Sales:**

	<b>(dollars in thousands)</b>	
	<b>For the Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2008</b>	<b>2007</b>
Lawn and pest control services	\$ 5,458	\$ 4,758
Telephone communications	1,187	1,733
Total cost of sales	\$ 6,645	\$ 6,491

***Lawn and Pest Control Services***

Cost of sales in the lawn and pest control services segment increased by \$0.7 million or 14.7% to \$5.5 million or 38.4% of revenue for the three months ended March 31, 2008 as compared to \$4.8 million or 35.0% of revenue for the three months ended March 31, 2007.

Chemical costs increased by \$0.2 million for the three months ended March 31, 2008 as compared to the same period in 2007. The price of petro-based chemical and fertilizer products increased due to higher fuel prices.

Vehicle costs increased by \$ 0.4 million for the three months ended March 31, 2008 compared to the same period in 2007 primarily due to an increase in fuel and vehicle maintenance costs.

**Table of Contents****Telephone Communications**

Cost of sales in our telephone communications segment decreased by \$0.5 million or 31.5% to \$1.2 million or 46.0% of revenue for the three months ended March 31, 2008 as compared to \$1.7 million or 52.3% of revenue for the three months ended March 31, 2007, primarily related to a decrease in product costs due to a shift in product mix.

**Gross Profit:**

	(dollars in thousands)	
	For the Three Months Ended	
	March 31,	
	2008	2007
Lawn and pest control services	\$ 8,740	\$ 8,844
Telephone communications	1,391	1,583
Total gross profit	\$ 10,131	\$ 10,427

**Lawn and Pest Control Services**

The gross profit of the lawn and pest control services segment decreased by \$0.1 million or 1.2% to \$8.7 million or 61.6% of revenue for the three months ended March 31, 2008 as compared to \$8.8 million or 65.0% of revenue for the three months ended March 31, 2007.

**Telephone Communications**

The gross profit in the telecommunications segment decreased by \$0.2 million or 12.1% to \$1.4 million for the three months ended March 31, 2007 as compared to \$1.6 million for the three months ended March 31, 2007.

Gross profit decreased for the three months ended March 31, 2008 compared to the same time period in 2007 primarily due to a decrease in revenue. The gross margin increased to 54.0% in 2008 compared to 47.7% in 2007 due to a reduction in cost of sales resulting from a shift in product mix.

**Operating Expenses:****Selling, General and Administrative Expenses:**

	(dollars in thousands)	
	For Three Months Ended March	
	31,	
	2008	2007
Selling	\$ 1,918	\$ 2,379
General and administrative	7,792	7,258
Depreciation and amortization	1,159	708
Total operating expenses	\$ 10,869	\$ 10,345

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Selling, general and administrative expenses ( SG&A expense ) increased by \$0.5 million or 5.1% to \$10.9 million or 64.8% of revenue for the three months ended March 31, 2008 as compared to \$10.3 million or 61.1% of revenue for the three months ended March 31, 2007.

Selling expenses decreased by \$0.5 million or 19.4% to \$1.9 million or 11.4% of revenue for the three months ended March 31, 2008 as compared to \$2.4 million or 14.1% of revenue for the three months ended March 31, 2007.

Middleton s selling costs decreased by \$0.3 million for the three months ended March 31, 2008 as compared to the same time period in 2007 as a result of a decrease in advertising expense.

General and administrative expenses increased by \$0.5 million or 7.4% to \$7.8 million or 46.3% of revenue for the three months ended March 31, 2008 as compared to \$7.4 million or 43.8% of revenue for the three months ended March 31, 2008.

Middleton s general and administrative expenses increased by \$0.7 million for the three months ended March 31, 2008 as compared to the same period in 2007. The increase was primarily driven by payroll expenses which increased by \$0.2 million for the three month period ended March 31, 2008 as compared to the same period in 2007 as a result of the purchase and integration of several acquisitions, expansion of staff related to meeting our compliance requirements with regards to Sarbanes-Oxley and an increase in staff related to the conversion of our existing operating software to a new system. Occupancy expenses increased by \$0.1 million due to our expansion and increased facility lease rates. Health insurance expenses also increased by \$0.1 million.

Depreciation and amortization expenses increased by \$0.5 million or 63.9% to \$1.2 million or 6.9 % of revenue for the three months ended March 31, 2008 as compared to \$0.7 million or 4.2% of revenue for the three months ended March 31, 2007.

Corporate depreciation and amortization expenses increased by \$0.5 million for the three months ended March 31, 2008 as compared to 2007 mostly attributable to an increase in the amortization of intangible assets due to our acquisition activity coupled with the change in estimated useful life for customer lists from 8 years to 5 years, which occurred during the fourth quarter of fiscal year 2007.

**Other Income (Expenses):**

	<b>(dollars in thousands)</b>	
	<b>For the Three Months</b>	
	<b>Ended</b>	
	<b>March 31,</b>	
	<b>2008</b>	<b>2007</b>
Interest income	\$ 69	\$ 52
Interest expense	(349)	(388)
(Loss) gain on disposal of assets	(11)	32
 Total other income (expenses)	 \$ (291)	 \$ (304)

Other expenses decreased by \$13,000 or 4.3% for the three months ended March 31, 2008 as compared to the three months ended March 31, 2008.

**Table of Contents****Income Tax (Provision) from Continuing Operations:**

	(dollars in thousands) For the Three Months Ended March 31,	
	2008	2007
Income tax (provision)	\$ (39)	\$ (47)

The income tax provision from continuing operations decreased slightly for the three months ended March 31, 2008 as compared to the three months ended March 31, 2007. The income tax provision of \$39,183 for the three months ended March 31, 2008 relates to foreign income taxes incurred by Telecom FM. The Company did not recognize an income tax benefit for the three months ended March 31, 2008 as the Company has \$13.5 million of net operating losses carryforwards which expire in 2026 and which are fully reserved. In addition, the Company does not have any net operating loss carrybacks.

**Discontinued Operations:**

	(dollars in thousands) For the Three Months Ended March 31, 2007	
Income from discontinued operations, net of income taxes	\$	50
Gain (loss) on sale of assets from discontinued operations, net of income taxes		
Income from discontinued operations, net of taxes	\$	50

As indicated earlier, our significant divestitures have been recorded as discontinued operations:

On August 1, 2007, we sold all the outstanding shares of Percipia. The results of operations for the three months ended March 31, 2007 related to Percipia have been classified as discontinued operations.

**Table of Contents****Results of Operations****Results of Operations for the Six Months Ended March 31, 2008 as Compared to the Six Months Ended March 31, 2007.****Revenue:**

	<b>(dollars in thousands)</b>	
	<b>For the Six Months Ended</b>	
	<b>March 31,</b>	
	<b>2008</b>	<b>2007</b>
Lawn and pest control services	\$ 27,647	\$ 25,990
Telephone communications	5,049	5,876
Total revenue	\$ 32,696	\$ 31,866

***Lawn and Pest Control Services***

Revenue from the lawn and pest control services segment is comprised of lawn, pest control and termite services. Revenue in the segment increased by \$1.7 million or 6.4% for the six months ended March 31, 2008 as compared to the six months ended March 31, 2007. The revenue increase was primarily attributable to the integration of our acquisitions since December 31, 2006.

***Telephone Communications***

Our remaining telephone communications subsidiary, Telecom FM, manufactures and sells least-cost routing devices. Revenue from Telecom FM decreased by \$0.8 million or 14.1% for the six months ended March 31, 2008 as compared to the six months ended March 31, 2007. During the second quarter of fiscal year 2007 Telecom FM received a series of large orders due to a change in legislation. This did not occur in the quarter ended March 31, 2008.

**Cost of Sales:**

	<b>(dollars in thousands)</b>	
	<b>For the Six Months Ended</b>	
	<b>March 31,</b>	
	<b>2008</b>	<b>2007</b>
Lawn and pest control services	\$ 10,425	\$ 9,320
Telephone communications	2,339	3,219
Total cost of sales	\$ 12,764	\$ 12,539

***Lawn and Pest Control Services***

Cost of sales in the lawn and pest control services segment increased by \$1.1 million or 11.9% to \$10.4 million or 37.7% of revenue for the six months ended March 31, 2008 as compared to \$9.3 million or 35.9% of revenue for the six months ended March 31, 2007.

Chemical costs increased by \$0.4 million for the six months ended March 31, 2008 as compared to the same period in 2007. The price of petro-based chemical and fertilizer products increased due to higher fuel prices.

Vehicle costs increased by \$0.5 million for the six months ended March 31, 2008 compared to the same period in 2007 primarily due to an increase in fuel and vehicle maintenance costs.

***Telephone Communications***

Cost of sales in our telephone communications segment decreased by \$0.9 million or 27.3% to \$2.3 million or 46.3% of revenue for the six months ended March 31, 2008 as compared to \$3.2 million or 54.8% of revenue for the six months ended March 31, 2007, primarily related to a decrease in product costs due to a shift in product mix.



**Table of Contents****Gross Profit:**

	(dollars in thousands)	
	For the Six Months Ended	
	March 31,	
	2008	2007
Lawn and pest control services	\$ 17,222	\$ 16,671
Telephone communications	2,710	2,656
Total gross profit	\$ 19,932	\$ 19,327

***Lawn and Pest Control Services***

The gross profit of the lawn and pest control services segment increased by \$0.6 million or 3.3% to \$17.2 million or 62.3% of revenue for the six months ended March 31, 2008 as compared to \$16.7 million or 64.1% of revenue for the six months ended March 31, 2007.

The increase in gross profit of 3.3% for the six months ended March 31, 2008 over the same period in the prior year is proportionate to the increase in revenue during those periods.

***Telephone Communications***

The gross profit in the telecommunications segment increased by \$0.1 million or 2.0% to \$2.7 million for the six months ended March 31, 2008 as compared to \$2.6 million for the six months ended March 31, 2007.

Gross profit increased for the six months ended March 31, 2008 compared to the same time period in 2007 despite a decrease in revenue. The gross margin increased to 53.7% in 2008 compared to 45.2% in 2007 due to a shift in product mix.

**Operating Expenses:****Selling, General and Administrative Expenses:**

	(dollars in thousands)	
	For the Six Months Ended March	
	31,	
	2008	2007
Selling	\$ 3,928	\$ 4,209
General and administrative	16,204	14,394
Depreciation and amortization	2,330	1,379
Total operating expenses	\$ 22,462	\$ 19,982



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Selling, general and administrative expenses ( SG&A expense ) increased by \$2.5 million or 12.4% to \$22.5 million or 68.7% of revenue for the six months ended March 31, 2008 as compared to \$20.0 million or 62.7% of revenue for the six months ended March 31, 2007.

Selling expenses decreased by \$0.3 million or 6.7% to \$3.9 million or 12.0% of revenue for the six months ended March 31, 2008 as compared to \$4.2 million or 13.2% of revenue for the six months ended March 31, 2007.

Middleton's selling costs decreased by \$0.2 million for the six months ended March 31, 2008 as compared to the same time period in 2007 as a result of reduction in advertising expense.

General and administrative expenses increased by \$1.8 million or 12.6% to \$16.2 million or 49.6% of revenue for the six months ended March 31, 2008 as compared to \$14.4 million or 45.2% of revenue for the six months ended March 31, 2008.

Middleton's general and administrative expenses increased by \$1.8 million for the six months ended March 31, 2008 as compared to the same period in 2007. The increase in general and administrative expenses was primarily driven by:

An increase in payroll expense of \$0.7 million and an increase in payroll taxes of \$0.1 million for the six month period ended March 31, 2008 as compared to the same period in 2007 as a result of the purchase and integration of several acquisitions, expansion of staff related to meeting our compliance requirements with regards to Sarbanes-Oxley and an increase in staff related to the conversion of our existing operating software to a new system.

Occupancy expenses increased by \$0.2 million due to our expansion and increased facility lease rates.

The Company moved to a lockbox system in August 2007. Lockbox fees and statement fulfillment expenses were \$0.2 million for the six months ended March 31, 2008. There were no lockbox fees and statement costs for the same time period in 2007. The implementation of a lockbox system has enabled us to streamline our cash receipts processing and has improved our cash flow.

Vehicle expenses increased by \$0.2 million primarily due to higher fuel costs.

Professional fees increased by \$0.3 million due to the temporary use of IT and marketing consultants.

Depreciation and amortization expenses increased by \$0.9 million or 117.1% to \$2.3 million or 7.1% of revenue for the six months ended March 31, 2008 as compared to \$1.4 million or 4.3% of revenue for the six months ended March 31, 2007.

Corporate depreciation and amortization expenses increased by \$1.0 million for the six months ended March 31, 2008 as compared to 2007 due to a significant increase in the amortization of intangible assets due to our acquisition activity coupled with the change in estimated useful life for customer lists from 8 years to 5 years, which occurred during the fourth quarter of fiscal year 2007.

**Other Income (Expenses):**

	<b>(dollars in thousands)</b>	
	<b>For the Six Months Ended</b>	
	<b>March 31,</b>	
	<b>2008</b>	<b>2007</b>
Interest income	\$ 122	\$ 119
Interest expense	(728)	(676)
(Loss) gain on disposal of assets	(6)	11
Total other income (expenses)	\$ (612)	\$ (546)

Other expenses increased by \$0.1 million or 12.1% for the six months ended March 31, 2008 as compared to the six months ended March 31, 2008.

Middleton's interest expense increased by \$0.1 million for the six months ended March 31, 2008 as compared to the six months ended March 31, 2007. The lawn and pest services segment incurred an additional \$3.3 million in debt related to acquisitions since March 31, 2007.

**Table of Contents****Income Tax (Provision) Benefit from Continuing Operations:**

	(dollars in thousands)	
	For the Six Months Ended	
	March 31,	
	2008	2007
Income tax (provision) benefit	\$ (39)	\$ 270

Income tax benefit from continuing operations decreased by \$0.3 million for the six months ended March 31, 2008 as compared to the six months ended March 31, 2007. The income tax provision of \$39,183 for the six months ended March 31, 2008 relates to foreign income taxes incurred by Telecom FM. The Company did not have an income tax benefit for the six months ended March 31, 2008 as the Company has \$13.5 million of net operating losses carryforwards which expire in 2026 and which are fully reserved. In addition, the Company does not have any net operating loss carrybacks.

**Discontinued Operations:**

	(dollars in thousands)	
	For the Six Months	
	Ended	
	March 31, 2007	
Percipia, Inc. Net loss	\$	(308)
Pre-tax (loss) from discontinued operations		(308)
Income tax benefit		259
(Loss) from discontinued operations, net of income taxes		(49)
Gain on sale of assets from discontinued operations		2,183
Income tax (provision)		(822)
Gain on sale of assets from discontinued operations, net of income taxes		1,361
Income from discontinued operations, net of income taxes	\$	1,312

As indicated earlier, our significant divestitures have been recorded as discontinued operations:

On November 20, 2006, we closed a transaction to sell the real estate property associated with the previously sold high frequency radio business for \$2.7 million in cash and a recognized gain in the amount of \$2.2 million, \$1.4 million net of income taxes.

On August 1, 2007, we sold all the outstanding shares of Percipia. The results of operations for the six months ended March 31, 2007 related to Percipia have been classified as discontinued operations.

**Table of Contents****Liquidity and Capital Resources**

Generally our working capital needs are funded from operations and advances under our revolving line of credit. In the lawn care and pest control business segment customers are billed when service is rendered and payment is usually received in less than thirty (30) days. In the telecommunication business segment customers are billed when orders are shipped and payment is usually received in sixty (60) to one hundred twenty (120) days from the billing date.

Materials related to telecommunications equipment production must be purchased significantly in advance of the billing date and payment terms with vendors generally range between thirty (30) and sixty (60) days.

As of March 31, 2008, our liquidity and capital resources included cash and equivalents of \$3.3 million, a working capital surplus of \$0.4 million and \$2.0 million was available under our revolving line of credit. As of September 30, 2007, our liquidity and capital resources included cash and equivalents of \$2.8 million, a working capital deficit of \$(0.9) million and \$9.0 million available under our revolving line of credit.

Cash used in operating activities was \$1.9 million for the six months ended March 31, 2008 as compared to cash provided by operating activities of \$0.8 million for the six months ended March 31, 2007. During the six months ended March 31, 2008 the primary sources of cash from operating activities were increases in prepaid expenses of \$0.5 million, increases in inventories of \$0.2 million and an increase in customer deposits of \$0.4 million. The primary uses of cash from operating activities for the six months ended March 31, 2008 were increase in accounts receivable of \$1.2 million, reduction in accounts payable and accrued expenses of \$0.8 million and funding of cash loss of \$1.0 million.

Net cash used in investing activities was \$1.3 million during the six months ended March 31, 2008 as compared to cash provided by investing activities of \$0.6 million for the six months ended March 31, 2007. During the six months ended March 31, 2008 the primary uses of cash from investing activities were cash paid for the acquisition of Marshall of \$1.0 million and capital expenditures of \$0.3 million. For the six months ended March 31, 2007 the primary source of cash provided by investing activities was \$2.5 million of net proceeds from the sale of assets offset by \$1.5 million used for business acquisitions and \$0.2 million used for the purchase of capital expenditures.

Net cash provided by financing activities was \$3.7 million for the six months ended March 31, 2008 as compared to the repayment of debt of \$1.0 million for the six months ended March 31, 2007. During the six months ended March 31, 2008 the primary source of cash from financing activities was proceeds from revolving line of credit of \$3.8 million.

Cash flows from discontinued operations are included in the consolidated statement of cash flows within operating, investing and financing activities for the six months ended March 31, 2008 and 2007.

Our uses of cash for fiscal 2008 will be principally for working capital needs, capital expenditures and debt service. We are not anticipating significant acquisition activity in fiscal 2008. We believe that we can fund our planned business activities from a combination of cash flows from operations and funds available under our revolving line of credit. On February 12, 2008, we amended our revolving line of credit terms and conditions ( the Second Amendment ) which included an extension of the maturity date to January 7, 2009 from October 1, 2008, reduced the capacity under the credit agreement from \$16.0 million to \$13.5 million effective February 12, 2008, to \$12.75 million as of June 30, 2008 and to \$11.75 million as of September 30, 2008. The Second Amendment also modified the financial covenants relating to consolidated EBITDA, the leverage ratio and the fixed charge coverage ratio. Based on the revised financial covenants included in the Second Amendment, we were in compliance with the financial covenants in its revolving line of credit at March 31, 2008.

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**Recent Accounting Pronouncements**

See Note 2, Summary of Significant Accounting Policies in the Notes to the Condensed Consolidated Financial Statements for a discussion of recent accounting pronouncements and their effect, if any, on the Company.

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

Not applicable.

**Item 4. *Controls and Procedures***

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

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, at March 31, 2008, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms.

**(b) *Changes in Internal Controls***

There was no change in our internal controls or in other factors that could affect these controls during the quarter ended March 31, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II  
OTHER INFORMATION****Item 1. Legal Proceedings**

We are involved in litigation from time to time in the ordinary course of our business. Except for the litigation described below, we do not believe that any litigation in which we are currently involved, individually or in the aggregate, is material to our financial condition or results of operations.

In October 2007, the Company filed a lawsuit in the Circuit Court for the Ninth Judicial Circuit in the State of Florida against a number of former employees of Middleton for violation of their non-compete agreements. In addition, certain of these former employees pursued and hired away employees of Middleton which is also a violation of the existing employee non-compete agreements. The Company is seeking injunctive relief and damages. In October 2007, the Company also filed a lawsuit against a competitor for tortious interference alleging that they hired these former employees knowing that they were in violation of the Company's non-compete agreement. This matter was settled during the three months ended March 31, 2008 for an immaterial amount.

**Item 1A. Risk Factors**

Not applicable.

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

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

The Company held its Annual Meeting of Shareholders on February 21, 2008. At the meeting, the following persons were elected to serve as directors, with the votes indicated:

<b>Director</b>	<b>Affirmative Votes</b>	<b>Withheld Votes</b>
Joseph Di Martino	8,650,805	2,488,683
Mario B. Ferrari	7,962,656	3,176,832
Arnold Heggstad, Ph. D.	8,651,805	2,487,683
Steven Oppenheim	8,650,270	2,489,218
Richard C. Rochon	7,963,156	3,176,332
Charles P. Steinmetz	7,963,121	3,176,367

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

- 10.1 Second Amendment to the Credit Agreement dated as of February 12, 2008 by and among Sunair Services Corporation, its domestic subsidiaries from time to time parties thereto, the lenders parties thereto and Wachovia Bank, National Association as administrative agent for the lenders (incorporated by reference to Exhibit 10.1 in the Form 8-K filed with the SEC on February 15, 2008).
- 31.1 Certification by Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002\*
- 31.2 Certification by Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002\*
- 32.1 Certification by Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*
- 32.2 Certification by Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*

\* Filed herewith

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**SIGNATURES**

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

**SUNAIR SERVICES CORPORATION**

Date: May 15, 2008

/s/ John J. Hayes  
John J. Hayes  
*President and Chief Executive Officer*

Date: May 15, 2008

/s/ Edward M. Carriero, Jr.  
Edward M. Carriero, Jr.  
*Chief Financial Officer*

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