SUNAIR SERVICES CORP
Form 10-K
January 13, 2009

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

FORM 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended September 30, 2008

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________.

Commission File No. 1-04334
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
(561) 208-7400
(Address and telephone number, including area code, of registrant s principal executive offices)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $.10 per share	American Stock Exchange

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

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

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

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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. (Check one):

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

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately $6,523,007 as of March 31, 2008 based on the closing price of stock on the American Stock Exchange on said date. For purposes of the foregoing computation, all executive officers, directors and 10% beneficial owners of the Registrant are deemed to be affiliates. Such determination should not be deemed to be an admission that such executive officers, directors or 10% beneficial owners are, in fact, affiliates of the registrant.

As of December 10, 2008, there were issued and outstanding 13,091,088 shares of the Registrant s common stock.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III (Items 10, 11, 12, 13 and 14) is incorporated by reference from the Registrant s definitive proxy statement for its 2007 Annual Meeting of Shareholders (to be filed pursuant to Regulation 14A).

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CAUTIONARY STATEMENTS ABOUT FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K, other than purely historical information, including estimates, projections, statements relating to the business plans, objectives and expected operating results of Sunair Services Corporation and the assumptions upon which those statements are based, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by the words believe, project, expect, anticipate, estimate, intend, strategy, plan, may, should, will, continue, will likely result, and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in the section entitled Risk Factors (refer to Item 1A). Sunair Services Corporation undertakes no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I

ITEM 1. DESCRIPTION OF BUSINESS

Overview

Sunair Services Corporation (Sunair, the Company, us, we or our) is a Florida corporation organized in 1956 changed our corporate name from Sunair Electronics, Inc. to Sunair Services Corporation in November of 2005.

During fiscal 2008, we operated in two business segments: Lawn and Pest Control Services and Telephone Communications. Our Lawn and Pest Control Services segment provides lawn care and pest control services to both residential and commercial customers. Our Telephone Communications segment which installs and maintains telephone and fixed wireless systems was sold in September 2008 representing the completion of our strategy to shed our legacy businesses and focus on our core business which is providing lawn and pest control services to our customers.

On February 8, 2005, we closed a transaction with Coconut Palm Capital Investors II, Ltd. (Coconut Palm), pursuant to a stock purchase agreement which we entered into on November 17, 2004. Coconut Palm purchased from us 5,000,000 Units for an aggregate purchase price of $25 million. Each Unit consisted of (i) one share of our common stock, (ii) one warrant to purchase one share of our common stock at an exercise price of $6.00 per share with a term of three years and (iii) one warrant to purchase one share of our common stock at an exercise price of $7.00 per share with a term of five years. In connection with the investment by Coconut Palm, we formed a new Lawn and Pest Control Services segment for future acquisitions and operations.

Effective upon the closing of the Coconut Palm transaction, we entered into a management services agreement with an affiliate of Coconut Palm, RPC Financial Advisors, LLC (RPC), pursuant to which RPC agreed to provide management services for us. Richard C. Rochon and Mario B. Ferrari, both of whom are affiliates of Coconut Palm and each of whom are members of our Board of Directors and principal shareholders of the Company, are also affiliates of RPC. On January 7, 2008, the Company entered into a management services agreement (Management Services Agreement or the Amended Management Services Agreement) with RPC, which superseded and replaced the management services agreement (the Previous Management Services Agreement) dated February 8, 2005, as amended between the Company and RPC. The Amended Management Services Agreement is for a term of three years, commencing on February 8, 2008 and expiring on February 7, 2011. Pursuant to the Amended Agreement, RPC provides the Company with services similar to those provided under the prior management services agreement. We pay RPC a monthly management fee equal to one (1%) of the monthly gross revenues of the Company, which are payable monthly based on the preceding quarter. RPC will also receive a transaction fee of 2% of the Aggregate Consideration received by the Company in a Transaction (as such capitalized terms are defined in the Amended Management Services Agreement). After the initial term of three years, the Amended Management Services Agreement will automatically renew for successive one year terms, unless either RPC or the Company terminates the agreement upon 30 days notice. Please see Note 17 Related Parties in our consolidated financial statements included herein in Item 8.

In June 2005 with the acquisition of Middleton Pest Control, Inc., we made a strategic decision to become a leading provider of lawn and pest control services focusing primarily on residential customers. Previously, we had operated through two business segments: High Frequency Radio and Telephone Communications. Since that time we have executed our strategy and shifted our focus to the Lawn and Pest Control Services segment which resulted in a series of acquisitions and divestitures planned to enable us to grow our core business, Lawn Care and Pest Control Services, and shed our legacy businesses (Telephone Communications and High Frequency Radio).

Since June 2005 through September 30, 2008, our acquisitions and divestitures have been as follows:

Acquisitions:

June 2005 we acquired the issued and outstanding stock of Middleton Pest Control, Inc. (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. (Four Seasons).

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

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

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

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

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

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

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

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

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

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

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

Divestitures:

September 2006 we sold substantially all the assets of Sunair Communications, Inc. (Sunair Communications) 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 operating in our Telephone Communications business segment.

September 2008 we sold all the issued and outstanding stock of Telecom FM Limited (Telecom FM), a wholly owned subsidiary operating in our Telephone Communications business segment.

During this three year period we finalized the execution of our strategy by divesting our non-core assets while growing our core lawn and pest control services business via acquisitions and internally generated growth.

The Lawn and Pest Control Services Segment

The Lawn and Pest Control Services segment acquired its first company on June 7, 2005, through the acquisition by our subsidiary, Sunair Southeast Pest Holdings, Inc., of all of the outstanding capital stock of Middleton Pest Control, Inc., a lawn and pest control company with operations throughout the state of Florida. The aggregate purchase price for the outstanding capital stock of Middleton was $50.0 million, which was comprised of: (i) $35.0 million in cash; (ii) $5.0 million in the form of a subordinated promissory note; and (iii) 1,028,807 shares of our common stock. We also incurred closing costs of $1.6 million and assumed $1.4 million of liabilities for a total purchase price of $53.0 million. On July 29, 2005, Middleton acquired substantially all of the assets of Four Seasons, a pest control and lawn care services company located in Central Florida, for approximately $1.4 million in cash.

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In fiscal 2006, Middleton acquired four pest control companies. On December 16, 2005, Middleton acquired substantially all of the assets of Spa Creek, a pest control and termite services company located in Central Florida, for approximately $5.5 million in cash. We also incurred transaction costs of $233,419 for a total purchase price of $5.7 million. On January 9, 2006, Middleton acquired substantially all of the assets of Paragon, a pest control and termite services company headquartered in Port St. Lucie, Florida, for approximately $1.1 million, consisting of $800,000 cash, $100,000 in the form of a subordinated promissory note, approximately $50,000 in transaction costs and 17,036 shares of our common stock valued at $100,000. On February 28, 2006, Middleton acquired substantially all of the assets of Pestec, a pest control and lawn care services company headquartered in Sarasota, Florida, for approximately $800,000, consisting of $600,000 cash, $175,000 in the form of a subordinated promissory note and approximately $25,000 in transaction costs. On March 31, 2006, Middleton acquired Ron Fee, a pest control and termite services company located in Central Florida, for approximately $5.2 million, consisting of $4.0 million in cash and $1.2 million in the form of a subordinated promissory note. We also incurred transaction costs of approximately $325,000 for a total purchase price of $5,525,000.

In fiscal 2007, Middleton acquired 6 pest control service and lawn care service companies. On November 30, 2006, Middleton acquired substantially all of the assets of Archer, a pest control services company located in Orlando, Florida, for $3.3 million, consisting of $1.5 million in cash, $1.5 million in the form of a subordinated promissory note and 73,529 shares of the Company s common stock valued at $300,000. We also incurred approximately $150,400 of transactions costs related to this acquisition. 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. 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. We also incurred approximately $55,000 of transactions costs related to this acquisition. 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. We also incurred approximately $161,400 of transactions costs related to this acquisition. On August 27, 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 subordinated promissory note with $1.0 million secured by a letter of credit. We also incurred approximately $161,500 of transactions costs related to this acquisition. 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 a rate equal to 50% of the collections received by Longboat Key from a large commercial customer. We also incurred approximately $165,700 of transactions costs related to this acquisition.

In fiscal 2008, Middleton acquired substantially all of the assets of Marshall, a lawn care 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.

In fiscal 2009, we plan to focus on the organic growth of our core business within the Company s existing market area. Although we do not plan on making any acquisitions of lawn and pest control companies in fiscal 2009, we will consider selective acquisitions of lawn care and pest control companies if they are strategic to our business plan.

Business of Middleton

Overview

Middleton, with headquarters located in Orlando, Florida, provides lawn care services and pest control services to both residential and commercial customers. Middleton provides essential pest control services and protection against termite damage, rodents and insects to homes and businesses. In addition, Middleton supplies essential lawn care services to homes and businesses, which includes fertilization treatments and protection against disease, weeds and insects for lawns and shrubs. Middleton operates under Middleton Lawn and Pest Control and Middleton Pest Control, Inc.

Middleton was founded in 1952 as a single location in Orlando, Florida. Middleton has since grown to a network of 28 branches throughout Florida, from which it serves approximately 120,000 customer accounts as of September 30, 2008.

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Seasonality

The lawn and pest control business is seasonal in nature. The termite swarm season, which generally occurs in early spring but varies by region depending on climate, leads to the highest demand for termite control services and therefore the highest level of revenues. Weather conditions, such as hurricanes, affect the demand for lawn care services and may result in a decrease in revenues or an increase in costs.

Customers

As of September 30, 2008, approximately 88% of Middleton s accounts were residential representing approximately 84% of Middleton s revenues and approximately 12% of Middleton s accounts were commercial representing approximately 16% of Middleton s revenues.

The following table provides information regarding the services utilized by Middleton s revenue:

Service	**% of Revenue**
Lawn Care	58.2%
General Pest Control	20.6%
Termite	21.2%
Total	100.00%

As of September 30, 2008, approximately 37% of Middleton s customers use more than one service.

Inventories

Middleton has relationships with multiple vendors for lawn and pest control treatment products and maintains a sufficient level of chemicals, materials and other supplies to fulfill its immediate servicing needs and to alleviate any potential short-term shortage in availability from its national network of suppliers.

Competition

The lawn and pest control services industry, a highly fragmented industry which is actively consolidating, is made up of approximately 20,000 pest control firms nationally and approximately 2,300 in Florida. The top five firms account for approximately 30% of revenues in the national market and the top 100 firms account for approximately 50% of the revenues. The principal methods of competition include quality of service, name recognition, pricing, assurance of customer satisfaction and reputation.

Lawn Care Services. Competition in the market for lawn care services is strong, coming mainly from large national companies including TruGreen/Chemlawn and, to a lesser extent, from regional and local, independently owned firms and from homeowners who care for their own lawns.

Pest Control Services. Competition in the Florida market for pest control services is strong, coming mainly from regional and local, independently owned firms, and, to a lesser extent, from large national companies including Orkin and Terminix, and from homeowners who treat their own pest control problems.

Marketing and Distribution

Middleton markets its services through an integrated marketing communications strategy which includes television advertisement, yellow pages and local print advertising, direct mail, local events and tradeshows, telemarketing and email marketing targeted at reaching both prospective and current customers. Public relation initiatives are also used in targeting key external audiences, including trade, local and consumer media.

Services are sold through two main distribution channels, field sales representatives and the internet. Sales representatives use the point of sale data and targeted collateral materials to conduct door-to door solicitations. Middleton s website enables customers to order, pay, schedule and request information about services online.

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Environmental and Regulatory Considerations

Middleton is subject to various legislative and regulatory enactments that are designed to protect the environment, public health and consumer protection. Middleton believes that it is in substantial compliance with all such legislative and regulatory requirements. Compliance with these requirements has not had a material negative effect on its financial position, results of operations or liquidity.

The Federal Insecticide Fungicide and Rodentcide Act (as amended) is a federal law that grants the responsibility of the states to be the primary agent in enforcement and conditions under which pest control companies operate. Each state must meet certain guidelines of the Environmental Protection Agency in regulating the following: licensing, record keeping, contracts, standards of application, training and registration of products. This allows each state to institute certain features that set their regulatory programs in keeping with special interests of the citizens and the pest control companies wishes in each state. Florida has enacted such guidelines which regulate and license the pest control industry in Florida. The pest control industry is impacted by these federal and state regulations.

Employees

The number of persons employed by Middleton as of September 30, 2008 was 538, which includes 129 salespersons, 245 technicians, 62 branch and district managers, 50 office associates, 7 telemarketers, and 45 persons in Middleton s corporate office.

Subsequent Event

On December 31, 2008, we entered into a binding commitment with a financial institution to modify certain terms and conditions of our revolving line of credit representing the third amendment to our credit agreement. Among the amended terms and conditions was the extension of the maturity date to January 2, 2010 and reduction of the maximum credit limit from $11.75 million on September 30, 2008 to $7.75 million on December 31, 2008, to $7.5 million on March 31, 2009, to $6.75 million on June 30, 2009 and to $5.5 million on September 30, 2009. In addition, there were amendments to the financial covenants relating to the consolidated EBITDA, leverage ratio and fixed charge coverage ratio, which amendments were effective for the quarter ended September 30, 2008. The consolidated EBITDA requirement and the fixed charge coverage ratio were reduced and the leverage ratio was increased. See Note 6 Revolving Line of Credit and Note 19-Subsequent Event.

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ITEM 1A. RISK FACTORS

You should read and consider carefully each of the following factors, as well as the other information contained in, attached to or incorporated by reference in this report. If any of the following risks materialize, our financial condition and results of operations could be materially and adversely affected and the value of our stock could decline. The risks and uncertainties described below are those that we currently believe may materially affect us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business operations.

The demand for our services are affected by changes in general economic conditions and consumer confidence.

Changes in general economic conditions and consumer confidence affect the demand for our services. All of our operations are conducted in Florida at the present time and unfavorable economic conditions in Florida will adversely impact our business. The weakness in the Florida housing market, the high unemployment rate and the overall weakness in the national and international economies may reduce consumer confidence and related spending levels and in turn, reduce the demand for our services.

Our markets are highly competitive. Competition could reduce our market share and adversely impact our results of operations.

We operate in a highly competitive industry. Our revenues and earnings may be adversely affected by changes in competitive prices. Competition in the market for lawn care services is strong, coming mainly from large national companies including TruGreen/Chemlawn and, to a lesser extent, from local, independently owned firms and from homeowners who care for their own lawns. Competition in the market for pest control services is strong, coming mainly from regional and local, independently owned firms, and, to a lesser extent, from large national companies including Orkin and Terminix, and from homeowners who treat their own pest control problems.

We believe that the principal competitive factors in the market areas that we serve are quality of service, pricing, assurance of customer satisfaction and reputation. No assurance can be given that we will be able to compete successfully against current or future competitors or that the competitive pressures that we face will not result in reduced market share and negatively impact our financial performance.

We operate in a business that deals with changing technology

We operate in an environment that is constantly changing with the introduction of technological advancements. To be competitive we need to remain abreast of advances in chemical treatments, bait traps and other products and procedures used within the industry. No assurance can be given that we will be able to compete successfully against current or future competitors or that the competitive pressures that we face due to technological advancements will not result in reduced market share and negatively impact our financial performance.

We are geographically concentrated in Florida making us vulnerable to adverse weather conditions and climate specific seasonality which may affect the demand and profitability of our termite, pest control and lawn care services.

Our lawn and pest control operations are conducted in Florida and may be adversely affected by interruptions in business and property damage caused by severe weather conditions such as hurricanes, tropical storms and flooding. Middleton s business is also affected by the seasonal nature of its termite control services. The termite swarm season, which generally occurs in early spring but varies by region depending on climate, leads to the highest demand for termite control services and therefore the highest level of revenues. Weather conditions affect the demand for lawn care services and may result in a decrease in revenues or an increase in costs

Our inability to attract and retain skilled workers may impair growth potential and profitability.

Our ability to remain productive and profitable will depend substantially on our ability to attract and retain skilled workers. Our ability to expand our operations is in part impacted by our ability to increase our labor force. The demand for skilled employees is high, and the supply is very limited. A significant increase in the wages paid by competing employers could result in a reduction in our skilled labor force, increases in the wage rates paid by us, or both. If either of these events occurred, our capacity and profitability could be diminished, and our growth potential could be impaired.

Our financial performance may be impacted by increases in operating costs.

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Our financial performance is affected by factor costs, such as labor, health care, vehicle, fuel, and insurance premiums. In particular, our financial performance is affected by increases in operating costs, such as the increased fuel and petroleum based chemical costs experienced in fiscal 2008.

Increases in raw material prices, fuel prices and other operating costs adversely affect our results of operations.

Our financial performance is affected by the level of our operating expenses, such as fuel, raw materials, wages and salaries, employee benefits, health care, vehicle, and insurance costs, all of which may be subject to inflation. In fiscal 2008 and 2007, fuel prices have fluctuated widely. If fuel prices increase our costs of operating vehicles and equipment would also increase. Fuel price increases could also result in increases in the cost of fertilizer, and other petrochemicals used in our business. We cannot predict the extent to which we may experience future increases in fuel costs and other operating costs. To the extent such costs should increase, we may not be able to fully pass these increased costs through to our existing and prospective customers, thereby reducing our profitability.

Public perceptions that our products and services are not environmentally friendly or safe may adversely affect the demand for our services.

In providing our services, we use, among other things, fertilizers, herbicides and pesticides. Public perception that our products and services are not environmentally friendly or safe or are harmful to humans, whether justified or not, could lead to reduced demand for our services, impair our reputation, involve us in litigation, damage our brand names and otherwise have a material adverse effect on our business, financial condition and results of operations.

Our operations may be adversely affected if we are unable to comply with regulatory and environmental laws.

Our business is significantly affected by environmental laws and other regulations relating to the pest control and lawn care industries and by changes in such laws and the level of enforcement of such laws. We are unable to predict the level of enforcement of existing laws and regulations, how such laws and regulations may be interpreted by enforcement agencies or court rulings, or whether additional laws and regulations will be adopted. We believe our present operations comply with applicable federal, state and local environmental laws and regulations in all material respects. We also believe that compliance with such laws has had no material adverse effect on our operations to date. However, such environmental laws are changed frequently. We are unable to predict whether environmental laws will, in the future, materially affect our operations and financial condition. Penalties for noncompliance with these laws may include cancellation of licenses, fines, and other corrective actions, which would negatively affect our future financial results.

We may acquire other lawn care and pest control services businesses, which may adversely affect our operating results, financial condition and existing business.

Since June 2005 through the end of fiscal 2008, we have acquired 13 lawn care and pest control service companies. In fiscal 2009, we plan on concentrating on organic growth and do not plan on acquiring any new lawn care or pest control companies. However, we will consider selective acquisitions of lawn care and pest control companies in fiscal 2009 if they are strategic to our business plan. The success of our acquisition program will depend on, among other things:

- the availability of suitable candidates;
- competition from other companies for the purchase of available candidates;
- our ability to value those candidates accurately and negotiate favorable terms for those acquisitions;
- the availability of funds to finance acquisitions; and
- the availability of management resources to oversee the integration and operation of the acquired businesses.

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Financing for the acquisitions may come from several sources, including our existing cash on hand as well as the proceeds from the exercise of outstanding warrants, the incurrence of indebtedness or the issuance of additional common stock, preferred stock or other securities. The issuance of a material amount of additional securities could, among other things:

- result in substantial dilution of the percentage ownership of our shareholders at the time of issuance;
- result in the substantial dilution of our earnings per share;
- adversely affect the prevailing market price for our common stock; and
- result in increased indebtedness, which could negatively affect our liquidity and operating flexibility.

Our inability to successfully integrate businesses we acquire could have adverse consequences on our business.

We have experienced significant growth through acquisitions and we may make additional acquisitions in the future. Acquisitions result in greater administrative burdens and operating costs and, to the extent financed with debt, additional interest costs. We cannot assure you that we will be able to manage or integrate acquired companies or businesses successfully. The process of integrating our acquired businesses may be disruptive to our business and may cause an interruption of, or a loss of momentum in, our business as a result of the following factors, among others:

- loss of key employees or customers;
- possible inconsistencies in standards, controls, procedures and policies among the combined companies and the need to implement company-wide financial, accounting, information and other systems;
- failure to maintain the quality of services that the companies have historically provided;
- the need to coordinate geographically diverse organizations; and
- the diversion of management s attention from our day-to-day business as a result of the need to deal with any disruptions and difficulties and the need to add management resources to do so.

These disruptions and difficulties, if they occur, may cause us to fail to realize the cost savings, revenue enhancements and other benefits that we currently expect to result from that integration and may cause material adverse short- and long-term effects on our operating results and financial condition.

We may not realize the anticipated cost savings and other benefits from our acquisitions.

Even if we are able to integrate the operations of acquired businesses into our operations, we may not realize the full benefits of the cost savings, revenue enhancements or other benefits that we anticipate. The potential cost savings associated with an acquisition are based on analyses completed by our employees. These analyses necessarily involve assumptions as to future events, including general business and industry conditions, costs to operate our business and competitive factors, many of which are beyond our control and may not materialize. While we believe these analyses and their underlying assumptions to be reasonable, they are estimates which are difficult to predict and necessarily speculative in nature. If we achieve the expected benefits, they may not be achieved within the anticipated time frame. Also, the cost savings and other synergies from these acquisitions may be offset by costs incurred in integrating the companies, increases in other expenses, operating losses or problems in the business unrelated to these acquisitions.

Our indebtedness under our revolving line of credit may negatively impact our ability to implement our business plan.

We have a revolving line of credit with a financial institution. The revolving line of credit requires us to maintain specified financial ratios regarding leverage, interest coverage and EBITDA. The revolving line of credit also places certain restrictions on, among other things, our ability to create or incur indebtedness, pay or make dividends or other distributions, create or permit certain liens, enter into transactions with affiliates and merge or consolidate with other entities. As a result, a failure to maintain these specified financial ratios and the amount and terms of our indebtedness under the revolving line of credit may negatively impact our ability to implement our business plan. For example, it could:

- limit our ability to fund future acquisitions, working capital and capital expenditures;

- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;

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- increase our vulnerability to general economic and industry conditions;
- place us at a competitive disadvantage to our competitors that are less leveraged;
- require us to sell debt or equity securities or sell some of our core assets, possibly on unfavorable terms, in order to meet our payment obligations; and
- limit our ability to borrow additional funds.

Termination of our Amended Management Services Agreement could affect our business.

We are a party to an Amended Management Services Agreement with RPC pursuant to which RPC, subject to the oversight and review of our board of directors, provides us with certain management services. The Amended Management Services Agreement is for a term of three years and expires on February 7, 2011. After the initial three year term, the Amended Management Services Agreement will automatically renew for successive one year terms, unless either RPC or the Company terminates the agreement upon 30 days notice. These management services include, among other things:

- establishing certain office, accounting and administrative procedures;
- assisting us in trying to obtain financing relating to business operations and acquisitions;
- helping us in developing and implementing advertising, promotional and marketing programs;
- advising us with respect to securities matters as well as future acquisitions and dispositions;
- assisting us in developing tax planning strategies;
- formulating risk management policies; and
- other management services as may be requested by us.

Our arrangement may be terminated in accordance with certain provisions of the Amended Management Services Agreement. The termination of such agreement could have a significant adverse effect on us as we would no longer be able to benefit from RPC s knowledge, experience and guidance, and the loss of RPC s services as our manager could adversely affect our business plan and results of operations, our ability to raise additional capital and our ability to achieve enhanced profitability.

Our company is dependent on our ability to retain and hire management personnel to oversee the business operations

We are dependent upon the services of management personnel who are knowledgeable in the lawn and pest control services industry. The loss of key management personnel could have an adverse effect on us as we would no longer benefit from the knowledge and expertise they possess. In addition, our inability to attract or retain executive officers and employees to manage the company could seriously harm the business, results of operations and financial condition of the company.

Product liability claims or inadequate product liability insurance coverage may have a material adverse effect on our business, financial condition and future prospects.

We face an inherent risk of product liability exposure related to our use of pesticides and chemicals in our lawn and pest control business. An individual may bring a product liability claim against us if one of the products that we use causes, or appears to have caused, an injury. Product liability claims may result in:

- substantial monetary awards to plaintiffs;
- costs of related litigation;
- injury to our reputation; and

decreased demand for our products.

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We currently maintain product liability coverage against risks associated with our services. Insurance coverage may not be available in the future at an acceptable cost, if at all, or in sufficient amounts to protect us against such liability. The obligation to pay any product liability claim in excess of whatever insurance we are able to acquire could have a material adverse effect on our business, financial condition and future prospects.

Coconut Palm, an entity affiliated with two of our directors, has the ability to significantly influence the outcome of any matters submitted to a vote of our shareholders.

Two of our directors through their affiliation with Coconut Palm have the power to vote, in their sole discretion, all of the securities owned by the former limited partners of Coconut Palm. As of December 10, 2008, Coconut Palm beneficially owned approximately 52% of our common stock, assuming beneficial ownership is defined as including common stock ownership after exercising all warrants or options exercisable within 60 days of December 10, 2008. Therefore, Coconut Palm has the ability to significantly influence the outcome of any matters submitted to a vote of our shareholders. Risks that may result from this ability are largely focused on the following variables:

- the potential for making decisions which are based on a return on investment timetable which is based on the individual preferences and interests of the directors which may be different and in conflict with the more immediate horizon which may be expected in public equity markets at any point in time.

- the potential for investing in operating strategies which reflect a higher or lower relationship of risk and returns on investment than other common equity investors of the Company.

We do not anticipate paying any dividends on our common stock.

Over the last five years, we have not paid any dividends on our common stock. We anticipate that for the foreseeable future we will continue to retain any earnings for use in the operation of our business. Any future determination to pay cash dividends will be at the discretion of our board of directors and will depend on our earnings, capital requirements, financial condition and other factors deemed relevant by our board of directors.

Our shareholders may incur substantial dilution upon the exercising of outstanding warrants.

Our shareholders may incur substantial dilution of their percentage of ownership interests if our warrant holders exercise their warrants. As of December 10, 2008, we have warrants outstanding to purchase (i) 5 million shares of our common stock at an exercise price of $7.00 per share, which expire on February 7, 2010 and (ii) 1 million shares of our common stock at an exercise price of $6.30 per share, which will expire on January 27, 2011. Upon exercise of the warrants, up to an additional 6,000,000 shares of our common stock would be outstanding. In addition, the warrants issued to our warrant holders contain certain anti-dilution provisions that if triggered, would cause a decrease in the exercise price of the warrants and would result in more shares of common stock being issuable upon exercise of the warrants. The warrants also provide for other customary anti-dilution adjustments to the exercise price in the event of stock splits, stock dividends, recapitalizations, reorganizations, reclassifications, distributions and business combinations, as well as adjustments in the event of cash dividends and other specified distributions. Adjustments to the warrants pursuant to these provisions may result in significant dilution to the ownership interests of our existing shareholders and may adversely affect the market price of our common stock. The anti-dilution provisions may also limit our ability to obtain additional financing on terms favorable to us.

An increased number of shares of our common stock in the market may adversely impact the market price of our common stock.

Sales of large amounts of our common stock in the public market, exercise of the warrants held by our shareholders, completion of future purchases of companies in the lawn and pest control services sector in which shares of our common stock constitutes a part or all of the purchase price or completion of other sales of our common stock could adversely affect the prevailing market price of our common stock, even if our business is doing well. These potential sales could also impair our ability to raise additional capital through the sale of equity securities.

Our stock is thinly traded.

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While our stock trades on the American Stock Exchange, our stock is thinly traded and an investor may have difficulty in reselling his or her shares quickly. The low trading volume of our common stock is outside of our control, and we cannot guarantee that the trading volume will increase in the near future or that, even if it does increase in the future, it will be maintained. Without a large float, our common stock is less liquid than the stock of companies with broader public ownership and, as a result, the trading prices of our common stock may be more volatile. In addition, in the absence of an active public trading market, an investor may be unable to liquidate his or her investment in us. Trading of a relatively small volume of our common stock may have a greater impact on the trading price for our stock than would be the case if our public float were larger. We cannot predict the prices at which our common stock will trade in the future.

ITEM 2. DESCRIPTION OF PROPERTY

Middleton s corporate headquarters are located at 1736 33rd Street, Orlando, Florida 32839. Middleton leases the building where its corporate headquarters are located, which contains approximately 12,000 sq. ft. of floor space. The lease expires on June 1, 2015. In addition, Middleton leases 28 other branch offices in its business which operate in space held primarily under three to five year leases providing for fixed monthly rental payments. The following is a list of the district and branch locations:

Orlando District	**Daytona District**	**Tampa District**
Orlando, Florida (3)	Daytona Beach, Florida	Tampa, Florida
Kissimmee, Florida	Cocoa, Florida	Lakeland, Florida
Longwood, Florida	Orange City, Florida	Clearwater, Florida
Leesburg, Florida	Palm Coast, Florida	Sarasota, Florida
Clermont, Florida	New Smyrna, Florida	Brooksville, Florida
Gainesville, Florida	Melbourne, Florida	Odessa, Florida
Ocala, Florida	Vero Beach, Florida	Longboat Key, Florida
	St. Augustine, Florida	Naples, Florida
	Stuart, Florida	
	Jacksonville, Florida	
	West Palm Beach, Florida	

We believe that these facilities are well maintained, in compliance with environmental laws and regulations, in all material respects and adequately covered by insurance. We also believe that these leased facilities are not unique and could be replaced, if necessary, at the end of the term of the existing leases.

ITEM 3. 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. These matters were settled during the three months ended March 31, 2008 for an immaterial amount.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to the vote of security holders during the fourth quarter of fiscal 2008.

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PART II

ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES

The following table sets forth the high and low sale price of the Company s common stock as traded on the American Stock Exchange under the symbol SNR.

	High	Low
Year ended September 30, 2008		
First quarter	3.12	1.66
Second quarter	2.55	1.58
Third quarter	3.03	2.21
Fourth quarter	2.60	1.61
Year ended September 30, 2007		
First quarter	4.75	3.61
Second quarter	3.81	3.00
Third quarter	3.70	3.11
Fourth quarter	3.51	2.70

As of December 10, 2008, there were 368 shareholders of record.

Dividends

We paid no dividends on our common stock in fiscal 2008 or fiscal 2007. The payment of cash dividends will depend upon our earnings, consolidated financial position and cash requirements, our compliance with loan agreements and other relevant factors. Management does not presently intend to pay cash dividends on our common stock.

Equity Compensation Plan Information

The following table sets forth information, as of September 30, 2008, with respect to the Company s compensation plans under which the Company s common stock is authorized for issuance:

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by stockholders	6,857,949	$ 6.60	130,863
Equity compensation plans not approved by stockholders	0	0	0

Recent Sales of Unregistered Securities

None.

Issuer Repurchases

None.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our consolidated financial statements and related notes contained in Item 8 of this report Form 10-K. The following Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) includes the following sections:

Company Overview

Results of Operations

Liquidity and Capital Resources

Off-Balance Sheet Arrangements

Critical Accounting Policies

Recent Accounting Pronouncements

You should note that this MD&A discussion contains forward-looking statements that involve risks and uncertainties. Please see the section entitled *Risk Factors* at the beginning of Item 1A on pages 9 through 14 for important information to consider when evaluating such statements. You should read this MD&A in conjunction with the Company s financial statements and related notes included in Item 8.

Company Overview

Sunair Services Corporation 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 we embarked on a new strategy to become a leading regional provider of lawn and pest control services focusing mainly on residential customers.

We have completed the execution of our strategy which was to focus on growing our core business, Lawn and Pest Control Services, and to divest our legacy businesses (Telephone Communications and High Frequency Radio).

The acquisitions and divestitures for the years ended September 30, 2007 and 2008 are as follows:

Acquisitions:

November 2006 we acquired substantially all the assets of Archer.

February 2007 we acquired substantially all the assets of Valentine.

April 2007 we acquired substantially all the assets of Florida Exterminating.

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

August 2007 we acquired substantially all the assets of Howell.

September 2007 we acquired substantially all the assets of Longboat Key.

October 2007 we acquired substantially all the assets of Marshall.

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

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Dispositions:

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, a wholly owned subsidiary operating in our Telephone Communications business segment.

September 2008 we sold all the issued and outstanding stock of Telecom FM, a wholly owned subsidiary operating in our Telephone Communications business segment.

The divestiture of Telecom FM represents a key transaction for us. With the sale of this subsidiary, we finalized the execution of our strategy of divesting our non-core assets while growing our core lawn and pest control services business via acquisitions and internally generated growth.

Results of Operations

Fiscal Year Ended September 30, 2008 (fiscal 2008) compared to the Fiscal Year ended September 30, 2007 (fiscal 2007)

Revenue, Cost of Sales, and Gross Profit:

	(dollars in thousands) For the Year Ended September 30,	
	2008	**2007**
Revenue	$ 56,613	$ 53,016
Cost of sales	(21,643)	(19,286)
Gross profit	$ 34,970	$ 33,730

Revenue

Revenue from lawn and pest control services is comprised of lawn, pest control and termite services. Revenue increased by $3.6 million or 6.8% for fiscal 2008 as compared to fiscal 2007. The revenue increase was primarily attributable to the integration of our 6 acquisitions that took place throughout fiscal 2007 and which has been reflected for the entire year in fiscal 2008 coupled with our Marshall acquisition which took place on October 2, 2007.

Cost of Sales

Cost of sales in the lawn and pest control services increased by $2.4 million or 12.2% to $21.6 million or 38.2% of revenue for fiscal 2008 as compared to $19.3 million or 36.4% of revenue for fiscal 2007 due to the following factors:

Chemical costs increased by $0.7 million for fiscal 2008 as compared to fiscal 2007. The price of petroleum based chemical and fertilizer products increased due to higher oil prices.

Payroll costs increased by $0.7 for fiscal 2008 as compared to fiscal 2007 due to an increase in activity and wage increases. Most of the increase in payroll in fiscal 2008 compared to fiscal 2007 was due to the integration of our fiscal 2007 and fiscal 2008 acquisitions.

Vehicle costs increased by $1.0 million for fiscal 2008 compared to fiscal 2007 primarily due to an increase in fuel and vehicle maintenance costs.

Gross Profit

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The gross profit of the lawn and pest control services increased by $1.2 million or 3.7% to $35.0 million or 61.8% of revenue for fiscal 2008 as compared to $33.7 million or 63.6% of revenue for fiscal 2007.

Operating Expenses:

Selling, General and Administrative Expenses:

(dollars in