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SUNAIR ELECTRONICS INC  
Form 10QSB  
February 17, 2004

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

FORM 10-QSB

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

For the quarterly period ended December 31, 2003

OR

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

Commission file number I-4334

SUNAIR ELECTRONICS, INC.

-----  
(EXACT NAME OF SMALL BUSINESS ISSUER AS SPECIFIED IN ITS CHARTER)

FLORIDA  
-----

(STATE OR OTHER JURISDICTION  
OF INCORPORATION OR ORGANIZATION)

3005 SW THIRD AVE., FT. LAUDERDALE, FL.  
-----

(ADDRESS OR PRINCIPAL EXECUTIVE OFFICE)

59-0780772  
-----

(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

33315  
-----

(ZIP CODE)

ISSUER'S TELEPHONE NUMBER (INCLUDING AREA CODE)

(954) 525-1505  
-----

NONE  
-----

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR,  
IF CHANGED SINCE LAST REPORT)

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

Yes  No

Registrant's common stock - par value 10 cents, outstanding as of December 31, 2003 - 3,800,520 shares.

Transitional Small Business Disclosure format. Yes  No

SUNAIR ELECTRONICS, INC. AND SUBSIDIARY

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PART I. FINANCIAL INFORMATION

SUNAIR ELECTRONICS, INC. AND SUBSIDIARY  
CONSOLIDATED CONDENSED BALANCE SHEETS (UNAUDITED)

ASSETS

12/31/03

9/30/03



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## CONSOLIDATED CONDENSED STATEMENTS OF INCOME (UNAUDITED)

	THREE MONTHS ENDED	
	12/31/03	12/31/02
SALES	\$ 1,314,574	\$ 1,065,447
COST OF SALES	698,249	555,199
GROSS PROFIT	616,325	510,248
SELLING, GENERAL & ADMINISTRATIVE EXPENSES	486,551	495,525
OPERATING INCOME	129,774	14,723
OTHER INCOME:		
INTEREST INCOME	62,432	77,163
OTHER, NET	(1,167)	15,066
INCOME BEFORE PROVISION FOR INCOME TAXES	191,039	106,952
PROVISION FOR INCOME TAXES	(18,500)	(37,900)
NET INCOME	\$ 172,539	69,052
NET INCOME PER SHARE:		
BASIC	\$ 0.05	\$ 0.02
DILUTED	\$ 0.04	\$ 0.02
WEIGHTED AVERAGE SHARES OUTSTANDING:		
BASIC	3,764,966	3,692,570
DILUTED	3,857,433	3,711,702

The accompanying notes are an integral part of these financial statements

## CONSOLIDATED CONDENSED STATEMENT OF CASH FLOWS (UNAUDITED)

THREE MONTHS ENDED	
12/31/03	12/31/02

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CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME	\$ 172,539	\$ 69,052
ADJUSTMENTS TO RECONCILE NET INCOME TO		
NET CASH PROVIDED BY (USED IN)		
OPERATING ACTIVITIES:		
DEPRECIATION	39,465	32,201
AMORTIZATION	7,168	7,168
(INCREASE) DECREASE IN ASSETS:		
ACCOUNTS RECEIVABLE	1,221,360	(256,840)
INTEREST RECEIVABLE	(49,158)	(48,095)
INVENTORIES	(95,026)	(159,940)
PREPAID AND OTHER CURRENT ASSETS	(19,093)	(22,559)
INCREASE (DECREASE) IN LIABILITIES:		
ACCOUNTS PAYABLE AND ACCRUED EXPENSES	(230,123)	458,909
INCOME TAXES PAYABLE	(289,500)	(568,709)
	-----	-----
NET CASH PROVIDED BY (USED IN) OPERATING		
ACTIVITIES	757,632	(488,813)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
PURCHASE OF PROPERTY, PLANT, AND EQUIPMENT	(11,261)	(12,023)
PURCHASES OF INVESTMENTS	(499,398)	(714,687)
	-----	-----
NET CASH USED IN INVESTING ACTIVITIES	(510,659)	(726,710)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
EXERCISE OF STOCK OPTIONS	140,287	--
	-----	-----
NET CASH PROVIDED BY FINANCING ACTIVITIES	140,287	--
	-----	-----
NET INCREASE (DECREASE) IN CASH AND		
CASH EQUIVALENTS	387,260	(1,215,523)
CASH AND CASH EQUIVALENTS, AT BEGINNING		
OF YEAR	1,022,175	2,422,833
	-----	-----
CASH AND CASH EQUIVALENTS, AT END OF YEAR	\$ 1,409,435	\$ 1,207,310
	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
CASH PAID DURING THE YEAR FOR INCOME TAXES	\$ 308,000	\$ 640,000
	=====	=====

The accompanying notes are an integral part of these financial statements

### NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

1. BASIS OF CONSOLIDATED FINANCIAL STATEMENT PRESENTATION]

THE ACCOMPANYING UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS HAVE BEEN PREPARED BY THE COMPANY PURSUANT TO THE RULES AND REGULATIONS OF THE SECURITIES AND EXCHANGE COMMISSION AND IN ACCORDANCE WITH THE INSTRUCTIONS TO FORM 10-QSB AND DO NOT INCLUDE ALL THE INFORMATION AND

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FOOTNOTE DISCLOSURES NORMALLY INCLUDED IN CONSOLIDATED FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA. THE INFORMATION FURNISHED IN THE INTERIM FINANCIAL STATEMENTS INCLUDES NORMAL RECURRING ADJUSTMENTS AND REFLECTS ALL ADJUSTMENTS, WHICH, IN THE OPINION OF MANAGEMENT, ARE NECESSARY FOR A FAIR PRESENTATION OF SUCH FINANCIAL STATEMENTS. FOR FURTHER INFORMATION REFER TO THE CONSOLIDATED FINANCIAL STATEMENTS AND FOOTNOTES THERETO INCLUDED IN THE COMPANY'S MOST RECENT AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND NOTES THERETO INCLUDED IN ITS SEPTEMBER 30, 2003 ANNUAL REPORT ON FORM 10-KSB. OPERATING RESULTS FOR THE THREE MONTHS ENDED DECEMBER 31, 2003 ARE NOT NECESSARILY INDICATIVE OF THE RESULTS THAT MAY BE EXPECTED FOR THE YEAR ENDING SEPTEMBER 30, 2004.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### USE OF ESTIMATES

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THE PREPARATION OF FINANCIAL STATEMENTS IN CONFORMITY WITH ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA REQUIRES MANAGEMENT TO MAKE ESTIMATES AND ASSUMPTIONS THAT AFFECT THE REPORTED AMOUNTS IN THE CONSOLIDATED FINANCIAL STATEMENTS AND ACCOMPANYING NOTES. ACTUAL RESULTS COULD DIFFER FROM THOSE ESTIMATES.

#### ACCOUNTS RECEIVABLE

-----  
ACCOUNTS RECEIVABLE CONSIST OF BALANCES DUE FROM SALES. THE COMPANY MONITORS ACCOUNTS RECEIVABLE AND PROVIDES ALLOWANCES WHEN CONSIDERED NECESSARY. AS OF DECEMBER 31, 2003 AND SEPTEMBER 30, 2003 ACCOUNTS RECEIVABLE WERE CONSIDERED TO BE FULLY COLLECTIBLE, ACCORDINGLY NO ALLOWANCE FOR DOUBTFUL ACCOUNTS WAS PROVIDED. IF AMOUNTS BECOME UNCOLLECTIBLE, THEY WILL BE CHARGED TO OPERATIONS WHEN THAT DETERMINATION IS MADE. THE COMPANY HAS LIMITED EXPOSURE TO BAD DEBT AS DOMESTIC SALES ARE PRIMARILY TO THE U.S. GOVERNMENT OR LARGER DEFENSE CONTRACTORS. INTERNATIONAL SALES ARE PRIMARILY CASH IN ADVANCE OF SHIPMENT OR LETTERS OF CREDIT.

#### INVESTMENTS

-----  
CERTAIN INVESTMENTS THAT MANAGEMENT HAS THE INTENT AND ABILITY TO HOLD TO MATURITY ARE REPORTED AT COST, ADJUSTED FOR AMORTIZATION OF PREMIUMS AND ACCRETION OF DISCOUNTS THAT ARE RECOGNIZED IN INTEREST INCOME USING THE INTEREST METHOD OVER THE PERIOD TO MATURITY.

MARKETABLE AND DEBT SECURITIES WHICH MANAGEMENT HAS CLASSIFIED AS TRADING ARE CARRIED AT FAIR VALUE WITH NET UNREALIZED GAINS AND LOSSES REPORTED IN OPERATIONS. REALIZED GAINS AND LOSSES ON MARKETABLE EQUITY AND DEBT SECURITIES ARE RECOGNIZED UPON SALE USING THE SPECIFIC IDENTIFICATION METHOD.

#### INVENTORIES

-----  
INVENTORIES, WHICH CONSIST OF RAW MATERIALS, WORK-IN-PROCESS, AND FINISHED GOODS, ARE STATED AT THE LOWER OF COST OR MARKET VALUE, COST BEING DETERMINED USING THE FIRST IN, FIRST OUT METHOD. FIXED AND VARIABLE MANUFACTURING COSTS AND OVERHEAD ARE INCLUDED IN THE CARRYING VALUES OF FINISHED GOODS AND WORK-IN-PROCESS. THE COMPANY RECORDS RESERVES FOR INVENTORY SHRINKAGE AND OBSOLESCENCE, WHEN CONSIDERED NECESSARY. FOR THE THREE MONTHS ENDED DECEMBER 31, 2003 INVENTORY SHRINKAGE AND OBSOLESCENCE RESERVES INCREASED \$19,670.

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### PROPERTY, PLANT, AND EQUIPMENT

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PROPERTY, PLANT AND EQUIPMENT ARE CARRIED AT COST. DEPRECIATION IS PROVIDED OVER THE ESTIMATED USEFUL LIVES OF THE ASSETS USING BOTH THE STRAIGHT-LINE AND ACCELERATED METHODS. THE ESTIMATED USEFUL LIVES USED TO COMPUTE DEPRECIATION ARE AS FOLLOWS:

BUILDINGS AND IMPROVEMENTS	10 TO 30 YEARS
MACHINERY AND EQUIPMENT	4 TO 10 YEARS

THE COST OF MAINTENANCE AND REPAIRS IS CHARGED TO EXPENSE AS INCURRED; RENEWALS AND BETTERMENTS ARE CAPITALIZED. WHEN PROPERTIES ARE RETIRED OR OTHERWISE DISPOSED OF, THE COST OF SUCH PROPERTIES AND THE RELATED ACCUMULATED DEPRECIATION ARE REMOVED FROM THE ACCOUNTS. ANY PROFIT OR LOSS IS CREDITED, OR CHARGED TO INCOME.

### IMPAIRMENT OF LONG-LIVED ASSETS AND LONG-LIVED ASSETS TO BE DISPOSED OF

-----

THE COMPANY REVIEWS LONG-LIVED ASSETS FOR IMPAIRMENT WHENEVER EVENTS OR CHANGES IN CIRCUMSTANCES INDICATE THAT THE CARRYING AMOUNT OF AN ASSET MAY NOT BE RECOVERABLE. RECOVERABILITY OF ASSETS TO BE HELD AND USED IS MEASURED BY A COMPARISON OF THE CARRYING AMOUNT OF AN ASSET TO FUTURE UNDISCOUNTED CASH FLOWS EXPECTED TO BE GENERATED BY THE ASSET. IF SUCH ASSETS ARE CONSIDERED TO BE IMPAIRED, THE IMPAIRMENT TO BE RECOGNIZED IS MEASURED BY THE AMOUNT BY WHICH THE ASSETS EXCEEDS THE FAIR VALUE. ASSETS TO BE DISPOSED OF ARE REPORTED AT THE LOWER OF THE CARRYING AMOUNT OR FAIR VALUE LESS COSTS TO SELL.

### REVENUE RECOGNITION

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THE COMPANY AND ITS SUBSIDIARY USE THE ACCRUAL BASIS OF ACCOUNTING. SALES REVENUES ARE RECORDED WHEN PRODUCTS ARE SHIPPED AND TITLE HAS PASSED TO UNAFFILIATED CUSTOMERS. INTEREST AND DIVIDENDS EARNED ON INVESTMENTS ARE RECORDED WHEN EARNED.

### FAIR VALUE OF FINANCIAL INSTRUMENTS

-----

THE CARRYING AMOUNTS OF CASH AND CASH EQUIVALENTS, ACCOUNTS RECEIVABLE, ACCOUNTS PAYABLE AND ACCRUED LIABILITIES, APPROXIMATE FAIR VALUE DUE TO THE SHORT-TERM MATURITIES OF THESE ASSETS AND LIABILITIES. THE FAIR MARKET VALUE OF OTHER FINANCIAL INSTRUMENTS IS PROVIDED BY THE USE OF QUOTED MARKET PRICES AND OTHER APPROPRIATE VALUATION TECHNIQUES, BASED ON INFORMATION AVAILABLE AT YEAR-END.

### INCOME TAXES

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THE COMPANY ACCOUNTS FOR INCOME TAXES USING SFAS NO. 109, "ACCOUNTING FOR INCOME TAXES", WHICH REQUIRES RECOGNITION OF DEFERRED TAX LIABILITIES AND ASSETS FOR EXPECTED FUTURE TAX CONSEQUENCES OF EVENTS THAT HAVE BEEN INCLUDED IN THE FINANCIAL STATEMENTS OR TAX RETURNS. UNDER THIS METHOD, DEFERRED TAX LIABILITIES AND ASSETS ARE DETERMINED BASED ON THE DIFFERENCE BETWEEN THE FINANCIAL STATEMENT AND TAX BASES OF ASSETS AND LIABILITIES USING ENACTED TAX RATES IN EFFECT FOR THE YEAR IN WHICH THE DIFFERENCES ARE EXPECTED TO REVERSE. A VALUATION ALLOWANCE IS RECORDED FOR DEFERRED TAX ASSETS IF IT IS MORE LIKELY THAN NOT THAT SOME PORTION OR ALL OF THE DEFERRED TAX ASSETS WILL NOT BE REALIZED.

### RESEARCH AND DEVELOPMENT

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EXPENDITURES FOR RESEARCH AND DEVELOPMENT ARE CHARGED TO OPERATION AS INCURRED.

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3. INVENTORIES

INVENTORIES CONSIST OF THE FOLLOWING

	12/31/03	9/30/03
	-----	-----
MATERIALS	\$1,597,615	\$2,352,471
WORK IN PROGRESS	4,562,528	3,957,855
FINISHED GOODS	988,124	742,915
	-----	-----
	\$7,148,267	\$7,053,241
	=====	=====

4. EARNINGS PER COMMON SHARE -

BASIC EARNINGS PER SHARE AMOUNTS ARE COMPUTED BY DIVIDING THE NET INCOME BY THE WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING. DILUTED EARNINGS PER SHARE AMOUNTS ARE COMPUTED BY DIVIDING NET INCOME BY THE WEIGHTED AVERAGE NUMBER OF SHARES OF COMMON STOCK, COMMON STOCK EQUIVALENTS, AND STOCK OPTIONS OUTSTANDING DURING THE PERIOD.

5. INVESTMENTS -

INVESTMENTS INCLUDE PRIVATE EXPORT FUNDING CORPORATION (PEFCO) NOTES. THESE NOTES ARE GUARANTEED BY THE EXPORT-IMPORT BANK OF THE UNITED STATES, AN AGENCY OF THE UNITED STATES. THE COMPANY HAS CLASSIFIED THESE SECURITIES AS "HELD-TO-MATURITY" SECURITIES, IN ACCORDANCE WITH STATEMENT OF FINANCIAL ACCOUNTING STANDARDS (SFAS) NO. 115, "ACCOUNTING FOR CERTAIN INVESTMENTS IN DEBT AND EQUITY SECURITIES". HELD-TO-MATURITY SECURITIES ARE RECORDED AT AMORTIZED COST. AMORTIZATION OF RELATED DISCOUNTS OR PREMIUMS IS INCLUDED IN THE DETERMINATION OF NET INCOME.

6. INCOME TAXES:

DURING 1995, IT WAS DETERMINED THAT CONTINUED OPERATIONS OF ITS INTEREST CHARGE-DOMESTIC INTERNATIONAL SALES CORPORATION (IC-DISC) SUBSIDIARY'S TAX ELECTION WAS NO LONGER ADVANTAGEOUS TO THE COMPANY. ACCORDINGLY, THE TAX ELECTION OF THE SUBSIDIARY WAS DISCONTINUED AND ITS RETAINED EARNINGS OF APPROXIMATELY \$3,200,000 WERE DISTRIBUTED TO THE COMPANY. FEDERAL TAX REGULATIONS PROVIDE FOR THE TAXATION OF SUCH DISTRIBUTION OVER A TEN YEAR PERIOD IN EQUAL ANNUAL INCREMENTS. UTILIZING THE MAXIMUM TAX RATES, THE INCOME TAX CONSEQUENCE OF SUCH DISTRIBUTION WILL APPROXIMATE \$122,000 PER YEAR. NO INTEREST IS PAYABLE ON THIS UNPAID PORTION.

7. PREFERRED STOCK:

AT DECEMBER 31, 2003, THE COMPANY HAD 500,000 AUTHORIZED SHARES OF PREFERRED STOCK, NO PAR VALUE, THAT MAY BE ISSUED AT SUCH TERMS AND PROVISIONS AS DETERMINED BY THE BOARD OF DIRECTORS. NONE ARE OUTSTANDING.



8. STOCK OPTIONS:

AT THE FISCAL YEAR ENDED SEPTEMBER 30, 2003, OPTIONS TO PURCHASE 270,000 SHARES AT \$2.25 PER SHARE HAD BEEN ISSUED TO KEY EMPLOYEES OF THE COMPANY. ON NOVEMBER 6, 2003, THE COMPANY'S MAJORITY SHAREHOLDER SOLD 1,994,000 COMMON SHARES TO AN UNRELATED THIRD PARTY, WHEREBY THE NEW SHAREHOLDER OWNS APPROXIMATELY 53% OF THE COMPANY. DUE TO THE MAJORITY CHANGE IN OWNERSHIP, ALL OF THE COMPANY'S OUTSTANDING STOCK OPTIONS BECAME FULLY VESTED AND EXERCISABLE ON NOVEMBER 6, 2003. OPTIONS FOR 45,600 WERE EXERCISED IN FISCAL 2003 AND 62,350 WERE EXERCISED IN THE FIRST QUARTER OF FISCAL 2004. 162,050 STOCK OPTIONS ARE CURRENTLY EXERCISABLE. THE OPTIONS GRANTED SHALL BE EXERCISABLE UP TO AND INCLUDING FIVE YEARS FROM THE DATE OF GRANT.

9. RECENT ACCOUNTING PRONOUNCEMENTS

IN NOVEMBER 2002, THE FASB ISSUED INTERPRETATION NO. 45, "GUARANTOR'S ACCOUNTING AND DISCLOSURE REQUIREMENTS FOR GUARANTEES, INCLUDING INDIRECT GUARANTEES OF INDEBTEDNESS OF OTHERS" WHICH EXPANDS PREVIOUSLY ISSUED ACCOUNTING GUIDANCE AND DISCLOSURE REQUIREMENTS FOR CERTAIN GUARANTEES. THE INTERPRETATION REQUIRES AN ENTITY TO RECOGNIZE AN INITIAL LIABILITY FOR THE FAIR VALUE OF AN OBLIGATION ASSUMED BY ISSUING A GUARANTEE. THE INITIAL RECOGNITION AND INITIAL MEASUREMENT PROVISIONS OF FIN NO. 45 ARE APPLICABLE TO A COMPANY ON A PROSPECTIVE BASIS TO GUARANTEES ISSUED OR MODIFIED AFTER DECEMBER 31, 2002. HOWEVER, THE DISCLOSURE REQUIREMENTS IN FIN NO. 45 ARE EFFECTIVE FOR A COMPANY'S FINANCIAL STATEMENTS FOR PERIODS ENDING AFTER DECEMBER 15, 2002. THE COMPANY IS NOT A PARTY TO ANY AGREEMENT IN WHICH IT IS A GUARANTOR OF INDEBTEDNESS OF OTHERS THEREFORE THE INTERPRETATION DID NOT AFFECT THE COMPANY'S FINANCIAL POSITION, RESULTS OF OPERATIONS OR CASH FLOWS.

IN JANUARY 2003, THE FASB ISSUED INTERPRETATIONS NO. 46, "CONSOLIDATION OF VARIABLE INTEREST ENTITIES". FIN NO. 46 ADDRESSES CONSOLIDATION BY BUSINESS ENTERPRISES OF VARIABLE INTEREST ENTITIES (FORMERLY SPECIAL PURPOSE ENTITIES OR "SPES"). THE COMPANY DOES NOT HAVE ANY VARIABLE INTEREST ENTITIES AS DEFINED BY FIN NO. 46 AND THEREFORE THE INTERPRETATION DID NOT AFFECT THE COMPANY'S FINANCIAL POSITION, RESULTS OF OPERATIONS OR CASH FLOWS.

IN DECEMBER 2002, THE FASB ISSUED SFAS NO. 148, "ACCOUNTING FOR STOCK-BASED COMPENSATION - TRANSITION AND DISCLOSURE". SFAS NO. 148 DOES NOT ALTER THE PROVISIONS OF SFAS 123, NOR DOES IT REQUIRE STOCK-BASED COMPENSATION TO BE MEASURED UNDER THE FAIR-VALUE METHOD. RATHER, SFAS 148 PROVIDES ALTERNATIVE TRANSITION METHODS TO COMPANIES THAT ELECT TO EXPENSE STOCK-BASED COMPENSATION USING THE FAIR-VALUE APPROACH UNDER SFAS NO. 123. THE COMPANY WILL CONTINUE TO ACCOUNT FOR STOCK-BASED COMPENSATION IN ACCORDANCE WITH APB NO. 25. THE COMPANY HAS ADOPTED THE DISCLOSURE-ONLY PROVISIONS OF SFAS NO. 148. AS SUCH, THE COMPANY DOES NOT EXPECT THIS STANDARD TO HAVE A MATERIAL IMPACT ON ITS FINANCIAL POSITION OR RESULTS OF OPERATIONS.

IN APRIL 2003, THE FASB ISSUED STATEMENT NO. 149, "AMENDMENT OF STATEMENT NO. 133 ON DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES". THIS STATEMENT AMENDS AND CLARIFIES FINANCIAL ACCOUNTING AND REPORTING FOR DERIVATIVE INSTRUMENTS, INCLUDING CERTAIN DERIVATIVE INSTRUMENTS EMBEDDED IN OTHER CONTRACTS AND FOR HEDGING ACTIVITIES UNDER STATEMENT NO. 133, "ACCOUNTING FOR DERIVATIVES INSTRUMENTS AND HEDGING

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ACTIVITIES." THE PROVISIONS OF THIS STATEMENT ARE EFFECTIVE FOR ALL DERIVATIVES AND HEDGING ACTIVITIES ENTERED INTO AFTER JUNE 30, 2003. THE COMPANY DID NOT HAVE ANY DERIVATIVES OR HEDGING ACTIVITIES AND THEREFORE THE STANDARD DID NOT AFFECT THE COMPANY'S FINANCIAL POSITION, RESULTS OF OPERATIONS OR CASH FLOWS.

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IN MAY 2003, THE FASB ISSUED SFAS NO. 150 "ACCOUNTING FOR CERTAIN FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF BOTH LIABILITIES AND EQUITY". SFAS NO. 150 ESTABLISHES STANDARDS ON THE CLASSIFICATION AND MEASUREMENT OF CERTAIN INSTRUMENTS WITH CHARACTERISTICS OF BOTH LIABILITIES AND EQUITY. THE PROVISIONS OF SFAS NO. 150 ARE EFFECTIVE FOR FINANCIAL INSTRUMENTS ENTERED INTO OR MODIFIED AFTER MAY 31, 2002 AND TO ALL OTHER INSTRUMENTS THAT EXIST AS OF THE BEGINNING OF THE FIRST INTERIM FINANCIAL REPORTING PERIOD BEGINNING AFTER JUNE 15, 2003. SFAS NO. 150 DID NOT HAVE A MATERIAL EFFECT ON THE COMPANY'S FINANCIAL STATEMENTS.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

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#### CAUTIONARY STATEMENT REGARDING FORWARD LOOKING INFORMATION:

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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 GENERIC 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 FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION (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.

#### GENERAL:

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SUNAIR ELECTRONICS, INC. IS A FLORIDA CORPORATION ORGANIZED IN 1956. IT IS ENGAGED IN THE DESIGN, MANUFACTURE AND SALE OF HIGH FREQUENCY SINGLE SIDEBAND COMMUNICATIONS EQUIPMENT AND THE SOFTWARE DEVELOPMENT, DESIGN, INTEGRATION TESTING AND DOCUMENTATION OF C4ISR SYSTEMS UTILIZED FOR LONG RANGE VOICE AND DATA COMMUNICATIONS IN FIXED STATION, MOBILE AND MARINE MILITARY AND GOVERNMENTAL APPLICATIONS.

SUNAIR PRODUCTS AND ENGINEERING CAPABILITIES ARE MARKETED BOTH DOMESTICALLY AND INTERNATIONALLY AND ARE PRIMARILY INTENDED FOR STRATEGIC MILITARY AND OTHER GOVERNMENTAL APPLICATIONS. SALES ARE EXECUTED DIRECT THROUGH SYSTEMS ENGINEERING

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COMPANIES, WORLDWIDE COMMERCIAL AND FOREIGN GOVERNMENTAL AGENCIES OR DIRECT TO THE U.S. GOVERNMENT.

SUNAIR'S LINE OF EQUIPMENT IS COMPOSED OF PROPRIETARY HF/SSB RADIO EQUIPMENT AND ANCILLARY ITEMS SOLD AS OPERATING UNITS OR COMBINED INTO SOPHISTICATED SYSTEMS THAT MAY INTERFACE WITH WORKSTATIONS, ANTENNAE, POWER SOURCES, MODEMS, MESSAGE SWITCHING DEVICES, CRYPTOGRAPHIC EQUIPMENT SOFTWARE AND THE LIKE PROVIDED BY OTHERS. SUNAIR PRODUCTS EMPLOY ADVANCED SOLID STATE DESIGNS WITH COMPUTER CONTROLLED NETWORKING CAPABILITIES. IN ADDITION, THE COMPANY CUSTOM DESIGNS SYSTEMS INCORPORATING VARIOUS COMBINATIONS OF EQUIPMENT INTO RACKS AND CONTROL CONSOLES THAT MAY INTERFACE WITH VALUE ADDED PRODUCTS AND SYSTEMS OF OTHER MANUFACTURERS.

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### LIQUIDITY:

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FOR THE QUARTER ENDED DECEMBER 31, 2003, THE COMPANY HAD POSITIVE CASH FLOW FROM OPERATIONS OF \$757,632 DUE TO PAYMENTS RECEIVED AGAINST SEVERAL LARGE SHIPMENTS MADE IN THE FOURTH QUARTER OF FISCAL 2003. ACCOUNTS RECEIVABLE DECREASED FOR THE SAME REASON.

CASH FLOWS USED BY INVESTING ACTIVITIES FOR THE QUARTER ENDED DECEMBER 31, 2003 WERE \$510,659 WHICH CONSISTED OF SHORT TERM INVESTMENTS IN COMMERCIAL PAPER AND PURCHASES OF SMALL QUANTITIES OF COMPUTER EQUIPMENT.

CASH FLOWS PROVIDED BY FINANCING ACTIVITIES FOR THE QUARTER ENDED DECEMBER 31, 2003 WERE \$140,287 PROVIDED BY THE EXERCISE OF STOCK OPTIONS.

DURING THE FIRST THREE MONTHS OF FISCAL 2004, THE COMPANY HAD SHORT TERM INVESTMENTS AND CASH OR CASH EQUIVALENTS MORE THAN ADEQUATE TO COVER KNOWN REQUIREMENTS, UNFORESEEN EVENTS OR UNCERTAINTIES THAT MIGHT OCCUR. THE COMPANY'S KNOWN REQUIREMENTS CONSIST OF NORMAL OPERATING EXPENSES. DURING THIS THREE MONTH PERIOD, CASH AND CASH EQUIVALENTS HAD AN AVERAGE BALANCE OF \$1,629,000 AS OPPOSED TO AN AVERAGE BALANCE OF \$1,506,000 FOR THE TWELVE MONTHS ENDED SEPTEMBER 30, 2003. CASH EQUIVALENTS ARE TAX EXEMPT MONEY MARKET FUNDS THAT ARE READILY AVAILABLE FOR IMMEDIATE USE SHOULD THE OCCASION ARISE. IT IS ANTICIPATED THAT THE COMPANY WILL REMAIN AS LIQUID DURING FISCAL 2004. THE CURRENT RATIO OF THE COMPANY AS OF DECEMBER 31, 2003 WAS 26.1 COMPARED TO 13.8 AS OF SEPTEMBER 30, 2003.

THE COMPANY RECORDS RESERVES FOR INVENTORY SHRINKAGE AND OBSOLESCENCE, WHEN CONSIDERED NECESSARY. AS OF DECEMBER 31, 2003, ACCOUNTS AND NOTES RECEIVABLE WERE CONSIDERED TO BE FULLY COLLECTIBLE, ACCORDINGLY NO ALLOWANCE FOR DOUBTFUL ACCOUNTS WAS PROVIDED. IF AMOUNTS BECOME UNCOLLECTIBLE, THEY WILL BE CHARGED TO OPERATIONS WHEN THAT DETERMINATION IS MADE.

NON CASH INTERIM RESERVES ARE MAINTAINED TO COVER ITEMS SUCH AS WARRANTY REPAIRS IN PROCESS AND OTHER CHARGES THAT MAY BE IN DISPUTE. ALL MONETARY TRANSACTIONS ARE IN U.S. DOLLARS AND NO LETTERS OF CREDIT INVOLVE FOREIGN EXCHANGE.

### CAPITAL RESOURCES:

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DURING THE FIRST THREE MONTHS OF FISCAL 2004, \$11,261 WAS SPENT FOR CAPITAL ASSETS. THESE FUNDS WERE PRIMARILY USED FOR NEW COMPUTER HARDWARE. NO EXPENDITURES ARE COMTEMPLATED FOR PLANT EXPANSION OR EXTENSIVE MAINTENANCE IN FISCAL 2004. THE COMPANY HAS NO LONG TERM DEBT AND NONE IS CONTEMPLATED, EXCEPT THE COMPANY MAY INCUR DEBT TO FINANCE ACQUISITIONS ALTHOUGH THERE ARE CURRENTLY

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NO AGREEMENTS OR PROPOSALS IN CONNECTION WITH ANY ACQUISITIONS. LIABILITIES CONSIST OF CURRENT ACCOUNTS PAYABLE, ACCRUED EXPENSES RELATED TO THE CURRENT ACCOUNTING PERIOD, AND THE CURRENT AND LONG TERM PORTION OF INCOME TAXES PAYABLE.

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### RESULTS OF OPERATIONS:

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FIRST QUARTER OF FISCAL YEAR ENDED 2004 COMPARED TO FIRST QUARTER OF FISCAL YEAR ENDED 2003.

DURING THE FIRST QUARTER OF THE CURRENT FISCAL YEAR ENDED DECEMBER 31, 2003, SHIPMENTS OF \$1,314,574 WERE UP 23.4% OR \$249,127 FROM THE SAME QUARTER ONE YEAR AGO LARGELY DUE TO CONTINUED SHIPMENTS TO ONE U.S. CUSTOMER. DOMESTIC SHIPMENTS FOR THE FIRST THREE MONTHS OF THE CURRENT FISCAL YEAR WERE \$1,263,449, COMPARABLE TO SHIPMENTS FOR THE SAME PERIOD ONE YEAR AGO OF \$964,593, UP \$298,856 OR 31.0%. EXPORT SHIPMENTS FOR THE THREE MONTHS ENDED DECEMBER 31, 2003 WERE \$51,125 OR 3.9% OF TOTAL SALES, DOWN \$49,729 OR 49.3% FOR THE SAME PERIOD ONE YEAR AGO DUE TO REDUCED INTERNATIONAL ACTIVITY. RECEIPT OF INTERNATIONAL ORDERS DECLINED DUE TO SHORT DELAYS IN FUNDING FOR NEW CONTRACT AWARDS. NEGOTIATIONS FOR A \$1.7 MILLION ORDER HAS BEEN COMPLETED WITH A FOREIGN MINISTRY OF DEFENSE FOR DELIVERY BY APRIL 2004. BACKLOG OF \$5,132,000 WAS HIGHER AT DECEMBER 31, 2003 COMPARED TO \$2,892,000 AT DECEMBER 31, 2002 DUE TO ORDERS ON COMPLEX SYSTEMS RECEIVED IN THE LATTER PART OF FISCAL 2003. PROJECTED ORDERS REMAINING ON MULTI-YEAR CONTRACTS RECEIVED IN 1999 AND 2000 ARE NOT INCLUDED IN THIS BACKLOG.

COST OF SALES WAS SLIGHTLY HIGHER AT 53.1% OF SALES IN THE FIRST QUARTER OF FISCAL 2004 AS COMPARED TO 52.1% OF SALES FOR THE SAME PERIOD ONE YEAR AGO DUE TO THE PRODUCT MIX. INVENTORIES INCREASED 1.3% OR \$95,026 FOR THE FIRST QUARTER OF FISCAL 2004 DUE TO REQUIREMENTS FOR CURRENT DELIVERIES AS WELL AS PROJECTED ORDERS FOR THE NEAR TERM. INVENTORY LEVELS ARE ANTICIPATED TO REFLECT A DECLINE IN THE CURRENT YEAR DUE TO PROCUREMENTS OF INVENTORY IN FISCAL 2003 TO MEET FUTURE REQUIREMENTS.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES REMAINED STABLE WITH ONLY A SLIGHT REDUCTION OF 1.8% OR \$8,974 FOR THE FIRST QUARTER OF FISCAL 2004. THERE WERE NO SIGNIFICANT CHANGES FOR THE FIRST QUARTER OF FISCAL 2004 AS COMPARED TO THE FIRST QUARTER OF FISCAL 2003. EXPENSES CONTINUE TO BE INCURRED FOR EXPANDED MARKET EXPOSURE AND INCREASED PRODUCT APPLICATION.

INTEREST INCOME DECREASED SLIGHTLY AS LOWER YIELDS CONTINUE ON INVESTMENTS. OTHER INCOME DECREASED DUE TO REDUCED SALES OF SCRAP.

THE COMPANY CONTINUES TO FOCUS ON EXPANDING OUR SYSTEM ENGINEERING AND INTEGRATION CAPABILITIES IN NEW AND EXISTING MARKETS. PLANS CONTINUE UNDERWAY TO DEMONSTRATE AND QUALIFY OUR PRODUCTS AND CAPABILITIES FOR BOTH DOMESTIC AND INTERNATIONAL APPLICATION.

SUNAIR REACHED FINAL NEGOTIATIONS ON SEVERAL DOMESTIC AND INTERNATIONAL SYSTEM TYPE CONTRACTS AND CONTINUES NEGOTIATIONS ON OTHER NEW AND PREVIOUSLY IDENTIFIED PROJECTS. DUE TO THE COMPLEXITY AND THE LONG LEAD TIME FOR INTEGRATION AND TEST OF THESE SYSTEMS, DELIVERIES MAY EXTEND INTO FUTURE QUARTERS OF FISCAL 2004.

DURING 1995, IT WAS DETERMINED THAT CONTINUED OPERATIONS OF ITS INTEREST CHARGE-DOMESTIC INTERNATIONAL SALES CORPORATION (IC-DISC) SUBSIDIARY'S ELECTION WAS NO LONGER ADVANTAGEOUS TO THE COMPANY. ACCORDINGLY, THE ELECTION OF THE SUBSIDIARY WAS DISCONTINUED AND ITS RETAINED EARNINGS OF APPROXIMATELY \$3,200,000 WERE DISTRIBUTED TO THE COMPANY. FEDERAL TAX REGULATIONS PROVIDE FOR

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THE TAXATION OF SUCH DISTRIBUTION OVER A TEN YEAR PERIOD IN EQUAL ANNUAL INCREMENTS. UTILIZING THE MAXIMUM TAX RATES, THE INCOME TAX CONSEQUENCES OF SUCH DISTRIBUTION WILL APPROXIMATE \$122,000 PER YEAR. NO INTEREST IS PAYABLE ON THIS UNPAID PORTION.

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### RESULTS OF OPERATIONS: (CONTINUED)

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ON AUGUST 14, 2003 THE COMPANY ANNOUNCED THAT MR. MICHAEL HERMAN HAD ENTERED INTO A STOCK PURCHASE AGREEMENT WITH ITS 54% MAJORITY SHAREHOLDER, THE ROBERT URICHO, JR. TRUST, OF WHICH SHIRLEY URICHO WAS THE INCOME BENEFICIARY. AS A PREREQUISITE TO THIS ACQUISITION OF SUNAIR SHARES, SUNAIR'S DISINTERESTED DIRECTORS APPROVED THE TRANSACTION BASED UPON CONDITIONS OF AN AGREEMENT DATED AUGUST 14, 2003 BETWEEN MR. HERMAN AND SUNAIR ELECTRONICS, INC. THE TRANSACTION CLOSED ON NOVEMBER 6, 2003 AND MR. HERMAN IMMEDIATELY JOINED THE BOARD OF DIRECTORS AND BECAME THE CHAIRMAN OF THE BOARD.

### ITEM 3. CONTROLS AND PROCEDURES

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(A) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. THE TERM "DISCLOSURE CONTROLS AND PROCEDURES" IS DEFINED IN RULE 13A - 15(E) OF THE SECURITIES EXCHANGE ACT OF 1934, OR THE EXCHANGE ACT. THIS TERM REFERS TO THE CONTROLS AND PROCEDURES OF A COMPANY THAT ARE DESIGNED TO ENSURE THAT INFORMATION REQUIRED TO BE DISCLOSED BY A COMPANY IN THE REPORTS THAT IT FILES UNDER THE EXCHANGE ACT IS RECORDED, PROCESSED, SUMMARIZED AND REPORTED WITHIN REQUIRED TIME PERIODS. OUR CHIEF EXECUTIVE OFFICER AND OUR CHIEF FINANCIAL OFFICER HAVE CONCLUDED, BASED ON THEIR EVALUATION AS OF DECEMBER 31, 2003, THAT OUR DISCLOSURE CONTROLS AND PROCEDURES ARE EFFECTIVE FOR RECORDING, PROCESSING, SUMMARIZING AND TIMELY REPORTING THE INFORMATION WE ARE REQUIRED TO DISCLOSE IN OUR REPORTS FILES UNDER THE EXCHANGE ACT.

(B) CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING. THERE WERE NO SIGNIFICANT CHANGES IN THE COMPANY'S INTERNAL CONTROLS OR IN OTHER FACTORS THAT COULD SIGNIFICANTLY AFFECT THESE CONTROLS SUBSEQUENT TO THE DATE OF THE MOST RECENT EVALUATION OF THESE CONTROLS BY THE COMPANY'S CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER, INCLUDING ANY CORRECTIVE ACTIONS WITH REGARD TO SIGNIFICANT DEFICIENCIES AND MATERIAL WEAKNESSES.

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## PART II OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

NONE

### ITEM 2. CHANGES IN SECURITIES

NONE

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

NONE

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

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NONE

### ITEM 5. OTHER INFORMATION

THE COMPANY HELD ITS 2003 ANNUAL MEETING OF STOCKHOLDERS AT THE COMPANY'S OFFICES ON JANUARY 26, 2004. AT THE MEETING, THE FOLLOWING PERSONS WERE ELECTED OR RE-ELECTED TO SERVE AS DIRECTORS, WITH THE VOTES INDICATED:

DIRECTOR -----	AFFIRMATIVE VOTES -----	NEGATIVE VOTES -----
MICHAEL D. HERMAN	3,571,370	0
GERARD P. LAHENEY	3,571,370	0
JAMES E. LAURENT	3,571,370	0
DR. ARNOLD HEGGESTAD	3,570,398	972
STEVEN P. OPPENHEIM	3,570,398	972

ALSO AT THE MEETING THE STOCKHOLDERS APPROVED A PROPOSAL TO AMEND THE ARTICLES OF INCORPORATION OF THE COMPANY SO AS TO INCREASE THE AGGREGATE NUMBER OF SHARES OF COMMON STOCK, PAR VALUE \$.10 PER SHARE, THAT THE COMPANY IS AUTHORIZED TO ISSUE FROM 6,000,000 TO 25,000,000 AND THE AGGREGATE NUMBER OF SHARES OF PREFERRED STOCK, NO PAR VALUE PER SHARE, THAT THE COMPANY IS AUTHORIZED TO ISSUE FROM 500,000 TO 2,000,000. THESE PROPOSALS WERE APPROVED WITH 2,552,894 AFFIRMATIVE VOTES, 173,866 NEGATIVE VOTES AND 1,051,010 ABSTENTIONS OR NON-VOTES.

THE COMPANY HELD A BOARD OF DIRECTORS MEETING IMMEDIATELY FOLLOWING THE ANNUAL MEETING. AT THE BOARD MEETING, DR. HEGGESTAD AND MR. OPPENHEIM WERE ELECTED TO SERVE ON THE AUDIT COMMITTEE OF THE BOARD.

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### PART II OTHER INFORMATION (CONTINUED)

#### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

##### (A) EXHIBITS

- 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.

##### (B) REPORTS ON FORM 8-K

ON NOVEMBER 19, 2003, THE COMPANY FILED A FORM 8-K DISCLOSING INFORMATION UNDER ITEMS 1 AND 7.

ON NOVEMBER 26, 2003, THE COMPANY FILED FORM 8-K DISCLOSING INFORMATION UNDER ITEMS 7 AND 9.

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SIGNATURES

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PURSUANT TO THE REQUIREMENTS OF THE SECURITIES AND EXCHANGE ACT OF 1934, THE REGISTRANT HAS DULY CAUSED THIS REPORT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED THEREUNTO DULY AUTHORIZED.

SUNAIR ELECTRONICS, INC.

DATE FEBRUARY 17, 2004

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/S/ JAMES E. LAURENT

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JAMES E. LAURENT, PRINCIPAL  
EXECUTIVE OFFICER

DATE FEBRUARY 17, 2004

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/S/ SYNNOTT B. DURHAM

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SYNNOTT B. DURHAM, PRINCIPAL  
ACCOUNTING OFFICER