

ASTEC INDUSTRIES INC
Form 10-K
March 15, 2007

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

Form 10-K

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

For the fiscal year ended December 31, 2006

OR

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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 0-14714

ASTEC INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Tennessee

62-0873631

(State or other jurisdiction of incorporation or organization)

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

1725 Shepherd Road, Chattanooga, Tennessee

37421

(Zip Code)

(Address of principal executive offices)

Registrant's telephone number, including area code:

(423) 899-5898

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, \$.20 par value

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

(Title of class)

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes

No

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

No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to be best of the 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.

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

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Large accelerated filer

Accelerated filer Non-accelerated filer

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

Yes

No

(Form 10-K Cover Page - Continued)

As of June 30, 2006, the aggregate market value of the registrant's voting stock held by non-affiliates of the registrant was approximately \$640,123,000 based upon the closing sales price as reported on the

National Association of Securities Dealers Automated Quotation System National Market System.

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:

As of March 9, 2007, Common Stock, par value \$.20 - 21,792,479 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents have been incorporated by reference into the Parts of this Annual Report on Form 10-K indicated:

<u>Document</u>	<u>Form 10-K</u>
Proxy Statement relating to Annual Meeting of Shareholders to be held on May 1, 2007	Part III

ASTEC INDUSTRIES, INC.

2006 FORM 10-K ANNUAL REPORT

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Statements contained anywhere in this Annual Report on Form 10-K that are not limited to historical information are considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding:

- ◆ execution of our growth and operation strategy;
- ◆ plans for technological innovation;
- ◆ compliance with covenants in our credit facility and note purchase agreement;
- ◆ ability to secure adequate or timely replacement of financing to repay our lenders;
- ◆ liquidity and capital expenditures;
- ◆ compliance with government regulations;
- ◆ compliance with manufacturing and delivery timetables;
- ◆ forecasting of results;

- ◆ general economic trends and political uncertainty;
- ◆ government funding and growth of highway construction;
- ◆ integration of acquisitions;
- ◆ financing plans;
- ◆ industry trends;
- ◆ pricing and availability of oil;
- ◆ pricing and availability of steel;
- ◆ our presence in the international marketplace;
- ◆ suitability of our current facilities;
- ◆ future payment of dividends;
- ◆ competition in our business segments;
- ◆ product liability and other claims; and
- ◆ protection of proprietary technology.

These forward-looking statements are based largely on management's expectations which are subject to a number of known and unknown risks, uncertainties and other factors discussed in this report and in other documents filed by us with the Securities and Exchange Commission, which may cause actual results, financial or otherwise, to be materially different from those anticipated, expressed or implied by the forward-looking statements. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements to reflect future events or circumstances. You can identify these statements by forward-looking words such as "expect," "believe," "goal," "plan," "intend," "estimate," "may," "will" and similar expressions.

In addition to the risks and uncertainties identified elsewhere herein and in other documents filed by us with the Securities and Exchange Commission, the risk factors described in this document under the caption "Risk Factors" should be carefully considered when evaluating our business and future prospects.

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PART I

Item 1

. Business

General

Astec Industries, Inc. (the "Company") is a Tennessee corporation which was incorporated in 1972. The Company designs, engineers, manufactures and markets equipment and components used primarily in road building, utility and related construction activities. The Company's products are used in each phase of road building, from quarrying and crushing the aggregate to application of the road surface. The Company also manufactures certain equipment and components unrelated to road construction, including trenching, auger boring, directional drilling and industrial heat transfer equipment. The Company's subsidiaries hold 98 United States patents and 66 foreign patents, have 18 patent applications pending, and have been responsible for many technological and engineering innovations in the industry. The Company's products are marketed both domestically and internationally. In addition to equipment sales, the Company manufactures and sells replacement parts for equipment in each of its product lines and replacement parts for some competitors' equipment. The distribution and sale of replacement parts is an integral part of the Company's business.

The Company's thirteen manufacturing subsidiaries are: (i) Breaker Technology Ltd./Inc., which designs, manufactures and markets rock breaking and processing equipment and utility vehicles for mining; (ii) Johnson Crushers International, Inc., which designs, manufactures and markets portable and stationary aggregate and ore processing equipment; (iii) Kolberg-Pioneer, Inc., which designs, manufactures and markets aggregate processing equipment for the crushed stone, manufactured sand, recycle, top soil and remediation markets; (iv) Osborn Engineered Products SA (Pty) Ltd., which designs, manufactures and markets crushers, vibratory screening equipment, conveyors and turnkey plants and mills; (v) Astec Mobile Screens, Inc., formerly Production Engineered Products, Inc., which designs, manufactures and markets mobile screening plants, portable and stationary structures and vibrating screens for the material processing industries; (vi) Telsmith, Inc., which designs, manufactures and markets aggregate processing equipment for the production and classification of sand, gravel, and crushed stone for road and other construction applications; (vii) Astec, Inc., which designs, manufactures and markets hot-mix asphalt plants and related components; (viii) CEI Enterprises, Inc., which designs, manufactures and markets heat transfer equipment, small asphalt plants for the domestic and international markets and polymer and rubber blending systems for the hot-mix asphalt industry; (ix) Heatec, Inc., which designs, manufactures and markets thermal fluid heaters, asphalt heaters, polymer and rubber blending systems and other heat transfer equipment used in the Company's asphalt mixing plants and in other industries; (x) American Augers, Inc., which designs, manufactures and markets auger boring and directional drilling equipment; (xi) Astec Underground, Inc., formerly Trencor, Inc., which designs, manufactures, and markets heavy-duty (300 to 1,500 horsepower) Trencor trenchers, and a comprehensive line of Astec utility (10 to 299 horsepower) trenchers, vibratory plows, and attachments; (xii) Carlson Paving Products, Inc., which designs, manufactures and markets asphalt paver screeds, and a windrow pickup machine; and (xiii) Roadtec, Inc., which designs, manufactures and markets a line of milling machines used to recycle pavement, asphalt paving equipment and material transfer vehicles.

On June 30, 2004, the Company sold substantially all of the assets and liabilities of Superior Industries of Morris, Inc. (Superior) to Superior Industries, LLC. Superior was part of the Company's Aggregate and Mining Group.

The Company's strategy is to be the industry's most cost-efficient producer in each of its product lines, while continuing to develop innovative new products and provide first class service for its customers. Management believes that the Company is the technological innovator in the markets in which it operates and is well positioned to capitalize on the need to rebuild and enhance roadway and utility infrastructure, both in the United States and abroad.

Segment Reporting

The Company's business units have separate management teams and offer different products and services. The business units have been aggregated into four reportable business segments based upon the nature of the product or services produced, the type of customer for the products and the nature of the production process. The reportable business segments are (i) Asphalt Group, (ii) Aggregate and Mining Group, (iii) Mobile Asphalt Paving Group and

(iv) Underground Group. All remaining companies as well as corporate expenses and federal tax expenses for all business segments are included in the "Other Business Units" category for reporting.

Financial information in connection with the Company's financial reporting for segments of a business under Statement of Financial Accounting Standards (SFAS) No. 131 is included in Note 16 to "Notes to Consolidated Financial Statements - Operations by Industry Segment and Geographic Area," appearing in Appendix A of this report.

Asphalt Group

The Asphalt Group segment is made up of three business units: Astec, Inc. ("Astec"), Heatec, Inc. ("Heatec") and CEI Enterprises, Inc. ("CEI"). These business units design, manufacture and market a complete line of asphalt plants and related components, heating and heat transfer processing equipment and storage tanks for the asphalt paving and other non-related industries.

Products

Astec designs, engineers, manufactures and markets a complete line of portable, stationary and relocatable hot-mix asphalt plants and related components under the ASTEC® trademark. An asphalt mixing plant typically consists of heating and storage equipment for liquid asphalt (manufactured by CEI or Heatec); cold feed bins for blending aggregates; a drum mixer (batch or Double Barrel type unit) for drying, heating and mixing; a baghouse composed of air filters and other pollution control devices; hot storage bins or silos for temporary storage of hot-mix asphalt; and a control house. Astec introduced the concept of high plant portability in 1979. Its current generation of portable asphalt plants is marketed as the Six Pack™ and consists of six or more portable components, which can be disassembled, moved to the construction site and reassembled, thereby reducing relocation expenses. High plant portability represents an industry innovation developed and successfully marketed by Astec. Astec's enhanced version of the Six Pack™, known as the Turbo Six Pack™, is a highly portable plant which is especially useful in less populated areas where plants must be moved from job-to-job and can be disassembled and erected without the use of cranes.

The components in Astec's asphalt mixing plants are fully automated and use both microprocessor-based and programmable logic control systems for efficient operation. The plants are manufactured to meet or exceed federal and state clean air standards. Astec has also developed specialized asphalt recycling equipment for use with its hot-mix asphalt plants.

Heatec designs, engineers, manufactures and markets a variety of thermal fluid heaters, process heaters, waste heat recovery equipment, liquid storage systems and polymer and rubber blending systems under the HEATEC® trademark. For the construction industry, Heatec manufactures a complete line of asphalt heating and storage equipment to serve the hot-mix asphalt industry and water heaters for concrete plants. In addition, Heatec builds a wide variety of industrial heaters to fit a broad range of applications, including heating equipment for marine vessels, roofing material plants, refineries, chemical processing, rubber plants and agribusiness. Heatec has the technical staff necessary to custom design heating systems and has systems operating as large as 50,000,000 BTU's per hour.

CEI designs, engineers, manufactures and markets heating equipment and storage tanks for the asphalt paving industry and rubber and polymer blending systems. CEI's heating equipment uses hot oil, direct fired or electric heating processes. CEI's equipment includes portable and stationary tank models with capacities up to 35,000 gallons each. In addition, CEI manufactures low cost asphalt plants for international and domestic markets.

Marketing

Astec markets its hot-mix asphalt products both domestically and internationally. The principal purchasers of asphalt and related equipment are highway contractors. Asphalt equipment is sold directly to the customers through Astec's

domestic and international sales departments, although independent agents are also used to market asphalt plants and their components in international markets.

Heatec equipment is marketed through both direct sales and dealer sales. Manufacturers' representatives sell heating products for applications in industries other than the asphalt industry. CEI equipment is marketed only through direct sales.

In total, the products of the Asphalt Group segment are marketed by approximately 38 direct sales employees, 19 domestic independent distributors and 32 international independent distributors.

Raw Materials

Raw materials used in the manufacture of products include carbon steel and various types of alloy steel, which are normally purchased from steel distributors. Raw materials for manufacturing are normally readily available. Most steel is delivered on a "just-in-time" arrangement from the supplier to reduce inventory requirements at the manufacturing facilities.

Competition

This industry segment faces strong competition in price, service and product performance and competes with both large publicly-held companies with resources significantly greater than those of the Company and with various smaller manufacturers. Domestic hot-mix asphalt plant competitors include Gencor Industries, Inc. and Terex Roadbuilding. In the international market the hot-mix asphalt plant competitors include Ammann, Marini and Ermont. The market for the Company's heat transfer equipment is diverse because of the multiple applications for such equipment. Competitors for the construction product line of heating equipment include, among others, Gencor/Hyway Heat Systems, American Heating, Burke Heating Systems, Stansteel, Pearson Heating Systems and GTS Energy Systems. Competitors for the industrial product line of heating equipment include GTS Energy Systems, Fulton Thermal Corporation, Vapor Power International, NATCO, Broach and TFS, among others.

Employees

At December 31, 2006, the Asphalt Group segment employed 875 individuals, of which 656 were engaged in manufacturing, 87 in engineering and 132 in selling, general and administrative functions.

Backlog

The backlog for the hot-mix asphalt and heat transfer equipment at December 31, 2006 and 2005 was approximately \$111,053,000 and \$37,426,000, respectively. Management expects all current backlogs to be filled in 2007.

Aggregate and Mining Group

The Company's Aggregate and Mining Group is comprised of six business units focused on the aggregate, metallic mining and recycling markets. These business units achieve their strength by distributing products into niche markets and drawing on the advantages of brand recognition in the global market. These business units are Telsmith, Inc. ("Telsmith"), Kolberg-Pioneer, Inc. ("KPI"), Astec Mobile Screens, Inc. ("AMS"), Johnson Crushers International, Inc. ("JCI"), Breaker Technology Ltd./Breaker Technology Inc. ("BTI") and Osborn Engineered Products, SA (Pty) Ltd ("Osborn"). Previously, this group also included Superior Industries of Morris, Inc. (Superior). As discussed earlier, the Company sold substantially all of the assets and liabilities of Superior on June 30, 2004.

Products

Founded in 1906, Telsmith is the oldest subsidiary of the group. The primary markets served under the TELSMITH® trade name are the aggregate and metallic mining industries.

Telsmith core products are jaw, cone and impact crushers as well as vibrating feeders, inclined and horizontal screens. Telsmith also provides consulting and engineering services to provide complete "turnkey" processing systems. Both portable and modular plant systems are available in production ranges from 300 tph up to 1500 tph.

Recent additions to the Telsmith product lines are the TRAC10™ automated crusher control system and the 3258 hydraulic adjustable jaw crusher. Both products incorporate features that enhance the operator's ability to safely maintain the equipment and optimize productivity.

Telsmith maintains an ISO 9001:2000 certification, an internationally recognized standard of quality assurance. In addition, Telsmith has achieved CE designation (a standard for quality assurance and safety) on its jaw and cone crusher products marketed into European Union countries.

KPI designs, manufactures and supports a complete line of aggregate processing equipment for the sand and gravel, mining, quarrying and concrete recycling markets under the well-known Pioneer® and Kolberg® product brand names. This equipment, along with the full line of portable and stationary aggregate and ore processing products from JCI, are jointly marketed through an extensive network of KPI-JCI dealers.

Pioneer® products include a complete line of primary, secondary, tertiary and quaternary crushers, including jaws, cones, horizontal shaft impact, vertical shaft impact and roll crushers. KPI rock crushers are used by mining, quarrying and sand and gravel producers to crush oversized aggregate to salable size, in addition to their use for recycled concrete and asphalt. Equipment furnished by Pioneer can be purchased as individual components, as portable plants for flexibility or as completely engineered systems for both portable and stationary applications. Included in the portable area is a highly-portable Fast Pack® System, featuring quick setup and teardown, thereby maximizing production time and minimizing downtime. Also included in the portable Pioneer® line are the fully self-contained and self-propelled Fast Trax® Track-Mounted-Jaw and HSI Crushers in four different models, which are ideal for either recycle or hard rock applications, allowing the producer to move the equipment to the material.

Kolberg® sand classifying and washing equipment is relied upon to clean, separate and re-blend deposits to meet the size specifications for critical applications. The Kolberg® product line includes fine and coarse material washers, log washers, blade mills and sand classifying tanks. Screening plants are available in both stationary and highly portable models, and are complemented by a full line of radial stacking and overland belt conveyors.

Kolberg® conveying equipment, including telescopic conveyers, is designed to move or store aggregate and other bulk materials, in radial cone-shaped or windrow stockpiles. The Wizard Touch™ automated controls are designed to add efficiency and accuracy to whatever the stockpile specifications require.

AMS, located in Sterling, Illinois, develops, manufactures and markets mobile screening plants, portable and stationary screen structures and vibrating screens each designed for the recycle, crushed stone, sand and gravel, industrial and general construction industries. These screening plants include the AMS Vari-Vibe and Duo-Vibe high frequency screens. The AMS high frequency screens are used for chip sizing, sand removal and sizing recycled asphalt where conventional screens are not ideally suited.

During 2006, AMS expanded the track screening plant family with the introduction of the Fold 'n Go 2516KT and KDS 710T. Also, AMS continued the development of screen boxes with a focus on operation and maintenance. These new products are primarily marketed to the crushed stone, recycle, sand and gravel, and general construction industries.

Founded in 1995, JCI is one of the youngest subsidiaries in the group. JCI designs, manufactures and distributes portable and stationary aggregate and ore processing equipment. This equipment is used in the aggregate, mining and recycle industries. JCI's principal products are cone crushers, three-shaft horizontal screens, portable plants, and replacement parts for competitive equipment. JCI offers completely re-manufactured cone crushers and screens from its service repair facility.

JCI™ cone crushers are used primarily in secondary and tertiary crushing applications, and come in both remotely adjusted and manual models. Horizontal screens are low-profile machines for use primarily in portable applications. They are used to separate aggregate materials by sizes. JCI recently introduced the Combo™ screen. It features an inclined feed section with flat discharge section and utilizes the oval stroke impulse mechanism, and offers increased capacity particularly in scalping application where removal of fines is desired.

Portable plants combine various configurations of cone crushers, horizontal screens, Combo™ screens, and conveyors mounted on tow-away chassis. Portable plants allow the aggregate producers to quickly and efficiently move their equipment from one location to another. JCI and KPI market a portable rock crushing plant appropriately named the Fast Pack®. This complete but portable plant, with production capability in excess of 500 tons per hour when relocated, can be reassembled and ready for production in under four hours, making it one of the industry's most mobile and cost-effective high-capacity crushing systems. The Fast Pack® design reduces operating costs by as much as 30%, compared to traditional plant designs, and user-friendly controls provide a safer work environment.

JCI recently introduced a series of track-mounted products known as Fast Trax. These units are self contained and easily relocated. The models FT 5162 and FT 6203 were launched in 2004. In 2005 JCI introduced the models FT6203CC, FT300 and FT200. In 2006, JCI enhanced the FT6203 to include a dolly system which drastically improves the portability capabilities.

BTI designs, manufactures and markets hydraulic rock breaker systems for the aggregate, mining and recycling industries. They also design and manufacture a complete line of four-wheel drive articulated utility vehicles for underground mines and quarries. Complementing their DS Series of scaling vehicles is a new scaling vehicle that was introduced to the market in 2006. BTI's product line now includes a highly effective and innovative vibratory pick scaling attachment.

In addition to the quarry and mining industries, BTI designs, manufactures and markets a complete line of hydraulic breakers, compactors and demolition attachments for the North American construction and demolition markets. These attachments are designed to fit a variety of equipment including excavators, backhoe loaders, wheel loaders and skid steer loaders.

BTI offers an extensive aftermarket sales and service program through a highly qualified and trained dealer network.

Osborn designs, manufactures and markets a complete line of bulk material handling and minerals processing plant and equipment. This equipment is used in the aggregate, mineral mining, metallic mining and recycling industries. Osborn has been a licensee of TelSmith's technology for over 50 years. In addition to TelSmith, Osborn also manufactures under license of American Pulverizer (USA), IFE (Austria) and Mogensen (UK) and has an in-house brand, Hadfields. Osborn also offers the following equipment: double-toggle jaw crushers; rotary breakers; roll crushers; rolling ring crushers; mills; out-of-balance or exciter-driven screens and feeders; portable, track-mounted or fixed crushing and screening plants; conveyor systems; and a full range of idlers.

Marketing

Aggregate processing and mining equipment is marketed by approximately 65 direct sales employees, 215 independent domestic distributors and 59 independent international distributors. The principal purchasers of aggregate processing equipment include highway and heavy equipment contractors, open mine operators, quarry operators and

foreign and domestic governmental agencies.

Raw Materials

Raw materials used in the manufacture of products include carbon steel and various types of alloy steel, which are normally purchased from steel distributors. Raw materials for manufacturing are readily available. BTI purchases rock breakers under long-term purchasing contracts with a Japanese and a Korean supplier. The Japanese and South Korean suppliers have sufficient capacity to meet the Company's anticipated demand; however, alternative suppliers exist for these components should any supply disruptions occur.

Competition

The Aggregate and Mining Group faces strong competition in price, service and product performance. Aggregate processing and mining equipment competitors include Metso (Nordberg); Sandvik (formerly Svedala Industry AB); Cedarapids Inc., Powerscreen and Finley, subsidiaries of Terex Corporation; Deister; Eagle Iron Works; and other smaller manufacturers, both domestic and international.

Employees

At December 31, 2006, the Aggregate and Mining Group segment employed 1,483 individuals, of which 1,085 were engaged in manufacturing, 118 in engineering and engineering support functions, and 280 in selling, general and administrative functions.

Telsmith has a labor agreement covering approximately 156 manufacturing employees, which expires on September 14, 2007. None of Telsmith's other employees are covered by a collective bargaining agreement.

Approximately 105 of Osborn's manufacturing employees are members of three national labor unions with agreements that expire on June 30, 2008.

Backlog

At December 31, 2006 and 2005, the backlog for the Aggregate and Mining Group was approximately \$109,370,000 and \$76,991,000, respectively. Management expects all current backlogs to be filled in 2007.

Mobile Asphalt Paving Group

The Mobile Asphalt Paving Group is comprised of Roadtec, Inc. ("Roadtec") and Carlson Paving Products, Inc. ("Carlson"). Roadtec designs, engineers, manufactures and markets asphalt pavers, material transfer vehicles, milling machines and a line of asphalt reclaiming and soil stabilizing machinery. Carlson designs and manufactures asphalt paver screeds that attach to the asphalt paver to control the width and depth of the asphalt as it is applied to the roadbed. Carlson also manufactures Windrow pickup machines which transfer hot mix asphalt from the road bed into the paver's hopper.

Products

Roadtec's patented Shuttle Buggy® is a mobile, self-propelled material transfer vehicle which allows continuous paving by separating truck unloading from the paving process while remixing the asphalt. A typical asphalt paver must stop paving to permit truck unloading of asphalt mix. By permitting continuous paving, the Shuttle Buggy® allows the asphalt paver to produce a smoother road surface, as well as reduce the time required to pave the road surface. As a result of the pavement smoothness achieved with this machine, certain states now require the use of the Shuttle Buggy®. Studies using infrared technology have revealed problems caused by differential cooling of the

hot-mix during hauling. The Shuttle Buggy® remixes the material to a uniform temperature and gradation, thus eliminating these problems.

Asphalt pavers are used in the application of hot-mix asphalt to the road surface. Roadtec pavers have been designed to minimize maintenance costs while exceeding road surface smoothness requirements. Roadtec also manufactures a paver model designed for use with the material transfer vehicle described above, which is designed to carry and spray tack coat directly in front of the hot mix asphalt in a single process.

Roadtec manufactures milling machines designed to remove old asphalt from the road surface before new asphalt mix is applied. Roadtec's milling machine lines, for larger jobs, are manufactured with a simplified control system, wide conveyors, direct drives and a wide range of horsepower and cutting capabilities to provide versatility in product application. In 2006, a smaller, utility sized milling machine was introduced to address smaller jobs which require less than half-lane cutting widths. Additional upgrades and options are available from Roadtec to enhance its products and their capabilities.

In 2006, Roadtec introduced its first soil stabilizer which also doubles as an asphalt reclaiming machine for road rehabilitation. This product line is expected to grow to a total of three machine sizes/horsepower over the next several years.

Carlson's patented screeds are part of the asphalt paving machine that lays asphalt on the roadbed at a desired thickness and width, while smoothing and compacting the surface. Carlson screeds can be configured to fit many types of asphalt paving machines. A Carlson screed uses a hydraulic powered generator to electrify elements that heat a screed plate so that asphalt will not stick to it while paving. The generator is also available to power tools or lights for night paving. Carlson offers options which allow extended paving widths and the addition of a curb on the road edge.

Marketing

The Mobile Asphalt Paving Group equipment is marketed both domestically and internationally to highway and heavy equipment contractors, utility contractors and foreign and domestic governmental agencies. Mobile construction equipment is marketed both directly and through dealers. This segment employs 27 direct sales staff, 32 domestic independent distributors and 17 foreign independent distributors.

Raw Materials

Raw materials used in the manufacture of products include carbon steel and various types of alloy steel, which are normally purchased from steel distributors and other sources. Raw materials for manufacturing are normally readily available. Most steel is delivered on a "just-in-time" arrangement from the supplier to reduce inventory requirements at the manufacturing facilities. Components used in the manufacturing process include engines, gearboxes, power transmissions and electronic systems.

Competition

The Mobile Asphalt Paving Group faces strong competition in price, service and performance. Paving equipment and screed competitors include Caterpillar Paving Products, Inc., a subsidiary of Caterpillar, Inc.; Blaw-Knox Construction Equipment Company, a subsidiary of Ingersoll-Rand Company; CMI Corporation, a subsidiary of Terex Corporation; Vogeles, a subsidiary of Wirtgen; and Dynapac. The segment's milling machine equipment competitors include Wirtgen America, Inc.; CMI Corporation, a subsidiary of Terex Corporation; and Caterpillar, Inc.

Employees

At December 31, 2006, the Mobile Asphalt Paving Group segment employed 426 individuals, of which 290 were engaged in manufacturing, 29 in engineering and engineering support functions, and 107 in selling, general and administrative functions.

Backlog

The backlog for the Mobile Asphalt Paving Group segment at December 31, 2006 and 2005 was approximately \$12,404,000 and \$7,519,000, respectively. Management expects all current backlogs to be filled in 2007.

Underground Group

The Underground Group consists of two manufacturing companies, Astec Underground, Inc. ("Astec Underground"), previously named Trencher, Inc., and American Augers, Inc. ("American Augers"). These two business units design, engineer and manufacture a complete line of underground construction equipment and related accessories. Astec Underground produces heavy-duty Trencher trenchers and the Astec line of utility trenchers, vibratory plows, and compact horizontal directional drills. American Augers manufactures maxi drills and auger boring machines, and the downhole tooling to support these units for the underground construction market.

Products

Astec Underground produces 18 trencher models and 6 compact horizontal directional drills at its Loudon facility. American Augers manufactures 25 models of trenchless equipment at its location. In addition to these product models, each factory produces numerous attachments and tools for the equipment.

Astec branded products include trenchers and vibratory plows from 13 to 250 horsepower, and horizontal directional drill (HDD) models with pullback ratings from 6,000 to 100,000 pounds. These are sold and serviced through a network of 47 dealers that operate 94 locations worldwide.

Trencher heavy-duty trenchers are among the most powerful in the world. They have the ability to cut a trench 35 feet deep and 8 feet wide through solid rock in a single pass. Utilizing a unique mechanical power train, Trencher machines are used to trench pipelines, lay fiber optic cable, cut irrigation ditches, insert highway drainage materials, and more. Astec Underground also makes foundation trenchers that are used in areas where drilling and blasting are prohibited. Astec Underground manufactures a side-cutting rock saw, which permits trenching alongside vertical objects like fences, guardrails, and rock wall in mountainous terrain. The rock saw is used for laying water and gas lines, fiber optic cable, and constructing highway drainage systems, among other uses.

Four Road Miner® models are available with an attachment that allows them to cut a path up to 13.5 feet wide and 5 feet deep on a single pass. The Road Miner® has applications in the road construction industry and in mining and aggregate processing operations.

During 2002, Astec Underground designed and developed the Surface Miner, a maneuverable, 1,650-horsepower miner that can cut through rock 10 feet wide and up to 26 inches deep in a single pass. When equipped with a GPS unit and the automatic grade and slope system, the Surface Miner allows road construction contractors to match the exact specifications of a survey plan.

American Augers engineers, designs, manufactures, and markets a wide range of trenchless equipment. Today, American Augers is one of the largest manufacturers of auger boring machines in the world, designing and engineering state-of-the-art boring machines, directional drills and fluid/mud systems used in the underground construction or trenchless market. The company has one of the broadest product lines in the industry, It serves customers in the sewer, power, fiber-optic telecommunication, electric, oil and gas, and water industries throughout the world.

Marketing

Astec Underground and American Augers market their products domestically through direct sales representatives and a dealer network, as well as internationally through direct sales, independent dealers and sales agents. The Underground Group has approximately 12 North American sales associates who focus on both direct sales and the dealer network along with 5 associates who focus solely on international marketing and sales.

Raw Materials

Astec Underground and American Augers maintain excellent relationships with suppliers and have experienced minimal turnover. The purchasing group has developed partnering relationships with many of the company's key vendors to improve "just-in-time" delivery and thus lower inventory. Steel is the predominant raw material used to manufacture the products of the Underground Group, and is normally readily available. Components used in the manufacturing process include engines, hydraulic pumps and motors, gearboxes, power transmissions and electronics systems.

Competition

Competition for trenching, excavating, auger boring, directional drilling, and fluid/mud equipment includes Charles Machine Works (Ditch Witch), Tesmec, Vermeer and other smaller custom manufacturers.

Employees

At December 31, 2006, the Underground Group segment employed 421 individuals, of which 298 were engaged in manufacturing, 46 in engineering and 77 in selling, general and administrative functions.

Backlog

The backlog for the Underground Group segment at December 31, 2006 and 2005 was approximately \$9,701,000 and \$5,758,000, respectively. Management expects all current backlogs to be filled in 2007.

Other Business Units

This category consists of the Company's business units that do not meet the requirements for separate disclosure as an operating segment. At December 31, 2006, these other operating units included Astec Insurance Company and Astec Industries, Inc., the parent company.

Employees

At December 31, 2006, the Other Business Units segment employed 36 individuals, all of which were engaged in general and administrative functions.

Common to All Operating Segments

Although the Company has four reportable business segments, the following information applies to all operating segments of the Company.

Raw Materials

Raw materials used in the manufacture of products include carbon steel and various types of alloy steel, which are purchased from several sources including steel distributors, mills, toll processors and service centers. Raw materials

for manufacturing are normally readily available. Most steel is delivered on a "just-in-time" arrangement from the supplier to reduce inventory requirements at the manufacturing facilities. In 2004 many steel prices increased as much as 100%. There was some price weakening early in 2005 but the pricing slowly increased over the latter part of 2005 and 2006. Further consolidation in the plate market in 2006 has now reduced competition on that front. Management expects the price of plate to rise moderately over the course of 2007 with supply expected to be adequate.

Government Regulations

None of the Company's operating segments operate within highly regulated industries. However, air pollution control equipment manufactured by the Company, principally for hot-mix asphalt plants, must comply with certain performance standards promulgated by the federal Environmental Protection Agency under the Clean Air Act applicable to "new sources" or new plants. Management believes that the Company's products meet all material requirements of such regulations and of applicable state pollution standards and environmental protection laws.

In addition, due to the size and weight of certain equipment the Company manufactures, the Company and its customers sometimes confront conflicting state regulations on maximum weights transportable on highways. Also, some states have regulations governing the operation of asphalt mixing plants and most states have regulations relating to the accuracy of weights and measures, which affect some of the control systems manufactured by the Company.

Compliance with these government regulations has no material effect on capital expenditures, earnings, or the Company's competitive position within the market.

Employees

At December 31, 2006, the Company and its subsidiaries employed 3,241 individuals, of which 2,329 were engaged in manufacturing, 280 in engineering, including support staff, and 632 in selling, administrative and management functions.

Other than the TelSmith and Osborn labor agreements described under the Employee subsection of the Asphalt and Mining Group, there are no other collective bargaining agreements applicable to the Company. The Company considers its employee relations to be good.

Manufacturing

The Company manufactures many of the component parts and related equipment for its products, while several large components of their products are purchased "ready-for-use". Such items include engines, axles, tires and hydraulics. In many cases, the Company designs, engineers and manufactures custom component parts and equipment to meet the particular needs of individual customers. Manufacturing operations during 2006 took place at 15 separate locations. The Company's manufacturing operations consist primarily of fabricating steel components and the assembly and testing of its products to ensure that the Company achieves quality control standards.

Seminars and Technical Bulletins

The Company periodically conducts technical and service seminars, which are primarily for contractors, employees and owners of asphalt mixing plants. In 2006, approximately 400 representatives of contractors and owners of hot-mix asphalt plants attended seminars held by the Company in Chattanooga, Tennessee. These seminars, which are taught by Company management and employees, along with select outside speakers and discussion leaders, cover a range of subjects including, but not limited to, technological innovations in the hot-mix asphalt, aggregate processing, paving, milling, and recycling markets.

The Company also sponsors executive seminars for the management of the customers of Astec, Heatec, CEI and Roadtec. Primarily, members of the Company's management conduct the various seminars, but outside speakers and discussion leaders are also utilized.

During 2006, service training seminars were also held at the Roadtec facility for approximately 260 outside customer service representatives. Telsmith conducted 3 technical seminars for approximately 100 customer and dealer representatives during 2006 at its facility in Mequon, Wisconsin. KPI and JCI jointly conduct an annual dealer appreciation event called NDC (National Dealers Conference). The event offers the entire dealer network a preview of future product, marketing and promotional programs targeted by KPI and JCI to help them be successful businesses. Along with this event, both companies provide local, regional and national sales and service dealer training programs throughout the year.

During 2006, Astec Underground hosted 19 product training events for trenchers and horizontal drills at the Loudon, Tennessee facility. Over 145 people received technical and operational training at these product training events.

In addition to seminars, the Company publishes a number of technical bulletins and information bulletins detailing various technological and business issues relating to the asphalt industry.

Patents and Trademarks

The Company seeks to obtain patents to protect the novel features of its products. The Company's subsidiaries hold 98 United States patents and 66 foreign patents. There are 18 United States and foreign patent applications pending.

The Company and its subsidiaries have approximately 68 trademarks registered in the United States including logos for Astec, Telsmith, Roadtec and Trencor, and the names ASTEC, TELSMITH, HEATEC, ROADTEC, TRENCOR, AMERICAN AUGERS, KOLBERG, JCI and PIONEER. Forty trademarks are also registered in foreign countries, including Canada, Great Britain, Mexico, New Zealand, India and Italy. The Company has 10 United States and foreign trademark applications pending.

Engineering and Product Development

The Company dedicates substantial resources to engineering and product development. At December 31, 2006, the Company and its subsidiaries had 280 full-time individuals employed in engineering and design capacities. These resources are described in more detail in Appendix A herein.

Seasonality and Backlog

In the normal season trend, revenues are strongest during the first three quarters of the year with the fourth quarter consistently being the weakest of the quarters. Operations during the entire year in 2006 were significantly impacted by the various economic factors discussed in the following paragraphs.

As of December 31, 2006, the Company had a backlog for delivery of products at certain dates in the future of approximately \$242,528,000. At December 31, 2005, the total backlog was approximately \$127,694,000. The Company's contracts reflected in the backlog are not, by their terms, subject to termination. Management believes that the Company is in substantial compliance with all manufacturing and delivery timetables.

Competition

Each business segment operates in domestic markets that are highly competitive regarding price, service and product quality. While specific competitors are named within each business segment discussion above, imports do not generally constitute significant competition for the Company in the United States. In international sales, however, the

Company generally competes with foreign manufacturers that may have a local presence in the market the Company is attempting to penetrate.

In addition, asphalt and concrete are generally considered competitive products as a surface choice for new roads and highways. A portion of the interstate highway system is paved in concrete, but over 90% of all surfaced roads in the United States are paved with asphalt. Although concrete is used for some new road surfaces, asphalt is used for virtually all resurfacing, including the resurfacing of most concrete roads. Management does not believe that concrete, as a competitive surface choice, materially impacts the Company's business prospects.

Available Information

Our internet website can be found at www.astecindustries.com. We make available free of charge on or through our internet website, access to our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after such material is filed, or furnished, to the Securities and Exchange Commission.

Item 1A

. Risk Factors

Downturns in the general economy or the commercial construction industry may adversely affect our revenues and operating results.

General economic downturns, including downturns in the commercial construction industry, could result in a material decrease in our revenues and operating results. Demand for many of our products, especially in the commercial construction industry, is cyclical. Sales of our products are sensitive to the states of the U.S., foreign and regional economies in general, and in particular, changes in commercial construction spending and government infrastructure spending. In addition, many of our costs are fixed and cannot be quickly reduced in response to decreased demand. The following factors could cause a downturn in the commercial construction industry:

- a decrease in the availability of funds for construction;
- labor disputes in the construction industry causing work stoppages;
- rising gas and fuel oil prices;
- rising steel prices and steel-up charges;
- rising interest rates;
- energy or building materials shortages; and
- inclement weather.

A decrease or delay in government funding of highway construction and maintenance may cause our revenues and profits to decrease.

Many of our customers depend substantially on government funding of highway construction and maintenance and other infrastructure projects. Any decrease or delay in government funding of highway construction and maintenance and other infrastructure projects could cause our revenues and profits to decrease. Federal government funding of infrastructure projects is usually accomplished through bills, which establish funding over a multi-year period. In August 2005, the President signed into law, the Safe Accountable, Flexible and Efficient Transportation Equity Act - A Legacy for Users ("SAFETEA-LU"), which authorizes the appropriation of \$286.5 billion in guaranteed funding for federal highway, transit and safety programs. Although SAFETEA-LU guarantees federal funding at certain minimum levels, SAFETEA-LU and other legislation may be revised in future congressional sessions and federal funding of infrastructure may be decreased in the future, especially in the event of an economic recession. In addition, Congress could pass legislation in future sessions, which would allow for the diversion of highway funds for other national

purposes or could restrict funding of infrastructure projects unless states comply with certain federal policies.

The cyclical nature of our industry and the customization of the equipment we sell may cause adverse fluctuations to our revenues and operating results.

We sell equipment primarily to contractors whose demand for equipment depends greatly upon the volume of road or utility construction projects underway or to be scheduled by both government and private entities. The volume and frequency of road and utility construction projects is cyclical; therefore, demand for many of our products is cyclical. The equipment we sell is durable and typically lasts for several years, which also contributes to the cyclical nature of the demand for our products. As a result, we may experience cyclical fluctuations to our revenues and operating results.

An increase in the price of oil or decrease in the availability of oil could reduce demand for our products. Significant increases in the purchase price of certain raw materials used to manufacture our equipment could have a negative impact on the cost of production and related gross margins.

A significant portion of our revenues relates to the sale of equipment that produces asphalt mix. A major component of asphalt is oil, and asphalt prices correlate with the price and availability of oil. An increase in the price of oil or a decrease in the availability of oil would increase the cost of producing asphalt, which would likely decrease demand for asphalt, resulting in decreased demand for our products. This would likely cause our revenues and profits to decrease. In fact, rising gasoline, diesel fuel and liquid asphalt prices during the last three years significantly impacted the operating and raw material costs of our contractor and aggregate producer customers, and if they did not properly adjust their pricing could have reduced their profits and caused delays in some of their capital equipment purchases.

We were notified of and incurred steel price increases and steel surcharges beginning in early 2004. The pricing weakened in early 2005 and slowly increased over the latter part of 2005 and 2006. Factors contributing to the increased steel costs were: (1) China's strong economy and its increased steel consumption and purchase of U.S. scrap steel; (2) the weakened U.S. dollar's dissuasion of foreign steel exports to the U.S.; (3) shortages of coke and iron ore; and (4) increased demand for steel in Korea and the U.S. During early 2004, some types of steel were available on an allocation basis determined by prior year purchases, although currently needed steel is readily available. A portion of the increased steel costs has been passed to our customers by way of surcharges and price increases. Continued significant steel cost increases, in addition to potential limitation of the steel supply by mills, could negatively impact our gross margins and financial results. The Company expects steel prices will rise moderately during 2007 with supply being adequate.

Acquisitions that we have made in the past and future acquisitions involve risks that could adversely affect our future financial results.

We have completed ten acquisitions since 1994, one of which we disposed during 2004, and we may acquire additional businesses in the future. We may be unable to achieve the benefits expected to be realized from our acquisitions. In addition, we may incur additional costs and our management's attention may be diverted because of unforeseen expenses, difficulties, complications, delays and other risks inherent in acquiring businesses, including the following:

- we may have difficulty integrating the financial and administrative functions of acquired businesses;
- acquisitions may divert management's attention from our existing operations;
- we may have difficulty in competing successfully for available acquisition candidates, completing future acquisitions or accurately estimating the financial effect of any businesses we acquire;

- we may have delays in realizing the benefits of our strategies for an acquired business;
- we may not be able to retain key employees necessary to continue the operations of the acquired business;
- acquisition costs may deplete significant cash amounts or may decrease our operating income;
- we may choose to acquire a company that is less profitable or has lower profit margins than our company; and
- future acquired companies may have unknown liabilities that could require us to spend significant amounts of additional capital.

Competition could reduce revenue from our products and services and cause us to lose market share.

We currently face strong competition in product performance, price and service. Some of our national competitors have greater financial, product development and marketing resources than we have. If competition in our industry intensifies or if our current competitors enhance their products or lower their prices for competing products, we may lose sales or be required to lower the prices we charge for our products. This may reduce revenue from our products and services, lower our gross margins or cause us to lose market share.

Our success depends on key members of our management and other employees.

Dr. J. Don Brock, our Chairman and President, is of significant importance to our business and operations. The loss of his services may adversely affect our business. In addition, our ability to attract and retain qualified engineers, skilled manufacturing personnel and other professionals, either through direct hiring or acquisition of other businesses employing such professionals, will also be an important factor in determining our future success.

Difficulties in managing and expanding in international markets could divert management's attention from our existing operations.

In 2006, international sales represented approximately 27.0% of our total sales. We plan to continue to increase our presence in international markets. In connection with any increase in international sales efforts, we will need to hire, train and retain qualified personnel in countries where language, cultural or regulatory barriers may exist. Any difficulties in expanding our international sales may divert management's attention from our existing operations. In addition, international revenues are subject to the following risks:

- fluctuating currency exchange rates which can reduce the profitability of foreign sales;
- the burden of complying with a wide variety of foreign laws and regulations;
- dependence on foreign sales agents;
- political and economic instability of governments; and
- the imposition of protective legislation such as import or export barriers.

We may be unsuccessful in complying with the financial ratio covenants or other provisions of our amended credit agreement.

As of December 31, 2006, we were in compliance with the financial covenants contained in our credit agreement dated as of May 14, 2003, as amended. However, in the future we may be unable to comply with the financial covenants in our credit facility. If such violations occur, the lenders could elect to pursue their contractual remedies under the credit facility, including requiring immediate repayment in full of all amounts then outstanding. Additionally, this agreement expires in May 2007. We are currently involved in negotiations to secure a new credit arrangement; however the possibility exists that we may be unable to secure adequate or timely replacement of our existing financing to repay our lenders in the event of an unanticipated repayment demand or expiration of the

agreement. As of December 31, 2006, there were approximately \$5,990,000 of letters of credits outstanding and \$322,000 of guarantees outstanding under our Canadian credit agreement. No other loans were outstanding under this credit agreement; amounts may be borrowed in the future, however.

Our quarterly operating results are likely to fluctuate, which may decrease our stock price.

Our quarterly revenues, expenses and operating results have varied significantly in the past and are likely to vary significantly from quarter to quarter in the future. As a result, our operating results may fall below the expectations of securities analysts and investors in some quarters, which could result in a decrease in the market price of our common stock. The reasons our quarterly results may fluctuate include:

- general competitive and economic conditions;
- delays in, or uneven timing in, the delivery of customer orders;
- the seasonal trend in our industry;
- the introduction of new products by us or our competitors;
- product supply shortages; and
- reduced demand due to adverse weather conditions.

Period-to-period comparisons of such items should not be relied on as indications of future performance.

We may face product liability claims or other liabilities due to the nature of our business. If we are unable to obtain or maintain insurance or if our insurance does not cover liabilities, we may incur significant costs which could reduce our profitability.

We manufacture heavy machinery, which is used by our customers at excavation and construction sites and on high-traffic roads. Any defect in, or improper operation of, our equipment can result in personal injury and death, and damage to or destruction of property, any of which could cause product liability claims to be filed against us. The amount and scope of our insurance coverage may not be adequate to cover all losses or liabilities we may incur in the event of a product liability claim. We may not be able to maintain insurance of the types or at the levels we deem necessary or adequate or at rates we consider reasonable. Any liabilities not covered by insurance could reduce our profitability or have an adverse effect on our financial condition.

If we are unable to protect our proprietary technology from infringement or if our technology infringes technology owned by others, then the demand for our products may decrease or we may be forced to modify our products which could increase our costs.

We hold numerous patents covering technology and applications related to many of our products and systems, and numerous trademarks and trade names registered with the U.S. Patent and Trademark Office and in foreign countries. Our existing or future patents or trademarks may not adequately protect us against infringements, and pending patent or trademark applications may not result in issued patents or trademarks. Our patents, registered trademarks and patent applications, if any, may not be upheld if challenged, and competitors may develop similar or superior methods or products outside the protection of our patents. This could reduce demand for our products and materially decrease our revenues. If our products are deemed to infringe upon the patents or proprietary rights of others, we could be required to modify the design of our products, change the name of our products or obtain a license for the use of some of the technologies used in our products. We may be unable to do any of the foregoing in a timely manner, upon acceptable terms and conditions, or at all, and the failure to do so could cause us to incur additional costs or lose revenues.

If we become subject to increased governmental regulation, we may incur significant costs.

Our hot-mix asphalt plants contain air pollution control equipment that must comply with performance standards promulgated by the Environmental Protection Agency. These performance standards may increase in the future.

Changes in these requirements could cause us to undertake costly measures to redesign or modify our equipment or otherwise adversely affect the manufacturing processes of our products. Such changes could have a material adverse effect on our operating results.

Also, due to the size and weight of some of the equipment that we manufacture, we often are required to comply with conflicting state regulations on the maximum weight transportable on highways and roads. In addition, some states regulate the operation of our component equipment, including asphalt mixing plants and soil remediation equipment, and most states regulate the accuracy of weights and measures, which affect some of the control systems we manufacture. We may incur material costs or liabilities in connection with the regulatory requirements applicable to our business.

As an innovative leader in the asphalt and aggregate industries, we occasionally undertake the engineering, design, manufacturing and construction of equipment systems that are new to the market. Estimating the cost of such innovative equipment can be difficult and could result in our realization of significantly reduced or negative margins on such projects.

In the past, we have experienced negative margins on certain large, specialized aggregate systems projects. These large contracts included both existing and innovative equipment designs, on-site construction and minimum production levels. Since it can be difficult to achieve the expected production results during the project design phase, field testing and redesign may be required during project installation, resulting in added cost. In addition, due to any number of unforeseen circumstances, which can include adverse weather conditions, projects can incur extended construction and testing delays which can cause significant cost overruns. We may not be able to sufficiently predict the extent of such unforeseen cost overruns and may experience significant losses on specialized projects.

Our Articles of Incorporation, Bylaws, Rights Agreement and Tennessee law may inhibit a takeover, which could delay or prevent a transaction in which shareholders might receive a premium over market price for their shares.

Our charter, bylaws and Tennessee law contain provisions that may delay, deter or inhibit a future acquisition or an attempt to obtain control of us. This could occur even if our shareholders are offered an attractive value for their shares or if a substantial number or even a majority of our shareholders believe the takeover is in their best interest. These provisions are intended to encourage any person interested in acquiring us or obtaining control of us to negotiate with and obtain the approval of our Board of Directors in connection with the transaction. Provisions that could delay, deter or inhibit a future acquisition or an attempt to obtain control of us include the following:

- having a staggered Board of Directors;
- requiring a two-thirds vote of the total number of shares issued and outstanding to remove directors other than for cause;
- requiring advance notice of actions proposed by shareholders for consideration at shareholder meetings;
- limiting the right of shareholders to call a special meeting of shareholders;
- requiring that all shareholders entitled to vote on an action provide written consent in order for shareholders to act without holding a shareholders' meeting; and
- being governed by the Tennessee Control Share Acquisition Act.

In addition, the rights of holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of our preferred stock that may be issued in the future and that may be senior to the rights of holders of our common stock. In December 2005, our Board of Directors approved an Amended and Restated Shareholder

Protection Rights Agreement, which provides for one preferred stock purchase right in respect of each share of our common stock ("Rights Agreement"). These rights become exercisable upon the acquisition by a person or group of affiliated persons, other than an existing 15% shareholder, of 15% or more of our then-outstanding common stock by all persons. This Rights Agreement also could discourage bids for the shares of common stock at a premium and could have a material adverse effect on the market price of our shares.

Item 1B

. Unresolved Staff Comments

None

Item 2.

Properties

The location, approximate square footage, acreage occupied and principal function of the properties owned or leased by the Company are set forth below:

<u>Location</u>	<u>Approximate Square Footage</u>	<u>Approximate Acreage</u>	<u>Principal Function</u>
C h a t t a n o o g a , Tennessee	436,000	59	Offices and manufacturing - Astec (Asphalt Group)
C h a t t a n o o g a , Tennessee	-	63	Storage yard - Astec (Asphalt Group)
Rossville, Georgia	40,500	3	Manufacturing - Astec (Asphalt Group)
C h a t t a n o o g a , Tennessee	84,200	5	Offices and manufacturing - Heatec (Asphalt Group)
C h a t t a n o o g a , Tennessee	196,000	15	Offices and manufacturing - Roadtec (Mobile Asphalt Paving Group)
C h a t t a n o o g a , Tennessee	51,200	7	Manufacturing and parts warehouse - Roadtec (Mobile Asphalt Paving Group)
C h a t t a n o o g a , Tennessee	14,100	-	Leased Hanger and Offices - Astec Industries, Inc.
C h a t t a n o o g a , Tennessee	10,000	2	Corporate offices - Astec Industries, Inc.

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Mequon, Wisconsin	203,000	30	Offices and manufacturing - Telsmith (Aggregate and Mining Group)
Sterling, Illinois	60,000	8	Offices and manufacturing - AMS (Aggregate and Mining Group)
L a k e v i l l e , Massachusetts	800	-	Leased sales and service office - Telsmith (Aggregate and Mining Group)
Orlando, Florida	9,000	-	Leased machine repair and service facility -Roadtec (Mobile Asphalt Paving Group)
Columbus, Ohio	20,000	5	Leased Dealership-Buckeye Underground, LLC (Underground Group)
Loudon, Tennessee	299,000	108	Offices and manufacturing - Astec Underground (Underground Group)
Southlake, Texas	750	-	Sales Office - Astec Underground (Underground Group)
Eugene, Oregon	130,000	8	Offices and manufacturing - JCI (Aggregate and Mining Group)
Albuquerque, New Mexico	112,300	14	Offices and manufacturing - CEI (Asphalt Group) (partially leased to a third party)
Yankton, South Dakota	312,000	50	Offices and manufacturing - KPI (Aggregate and Mining Group)
West Salem, Ohio	100,000	29	Offices and manufacturing - American Augers (Underground Group)
Thornbury, Ontario, Canada	55,000	12	Offices and manufacturing - BTI (Aggregate and Mining Group)
Riverside, California	12,500	-	Leased offices and warehouse - BTI (Aggregate and Mining Group)
Solon, Ohio	5,700	-	Leased offices and assembly - BTI (Aggregate and Mining Group)

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Tacoma, Washington	41,000	5	Offices and manufacturing - Carlson (Mobile Asphalt Paving Group)
Cape Town, South Africa	4,600	-	Leased sales office and warehouse - Osborn (Aggregate and Mining Group)
Durban, South Africa	3,800	-	Leased sales office and warehouse - Osborn (Aggregate and Mining Group)
Witbank, South Africa	1,400	-	Leased sales office and warehouse - Osborn (Aggregate and Mining Group)
Welkom, South Africa	900	-	Leased sales office and warehouse - Osborn (Aggregate and Mining Group)
Johannesburg, South Africa	177,000	18	Offices and manufacturing - Osborn (Aggregate and Mining Group)

The properties above are owned by the Company unless they are indicated as being leased.

Management believes that each of the Company's facilities provides office or manufacturing space suitable for its current needs, and Management considers the terms under which it leases facilities to be reasonable.

Item 3

. Legal Proceedings

The Company is currently a party to various claims and legal proceedings that have arisen in the ordinary course of business. If management believes that a loss arising from such claims and legal proceedings is probable and can reasonably be estimated, the Company records the amount of the loss (including estimated legal costs), or the minimum estimated liability when the loss is estimated using a range, and no point within the range is more probable than another. As management becomes aware of additional information concerning such contingencies, any potential liability related to these matters is assessed and the estimates are revised, if necessary. If management believes that a loss arising from such claims and legal proceedings is either (i) probable but cannot be reasonably estimated or (ii) reasonably possible but not probable, the Company does not record the amount of the loss, but does make specific disclosure of such matter. Based upon currently available information and with the advice of counsel, management believes that the ultimate outcome of its current claims and legal proceedings, individually and in the aggregate, will not have a material adverse effect on the Company's financial position, cash flows or results of operations. However, claims and legal proceedings are subject to inherent uncertainties and rulings unfavorable to the Company could occur. If an unfavorable ruling were to occur, there exists the possibility of a material adverse effect on the Company's financial position, cash flows or results of operations.

Item 4

. Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the fiscal quarter ended December 31, 2006.

Executive Officers of the Registrant

The name, title, ages and business experience of the executive officers of the Company are listed below.

J. Don Brock, Ph.D., P.E.,

has been President and a Director of the Company since its incorporation in 1972 and assumed the additional position of Chairman of the Board in 1975. He was the Treasurer of the Company from 1972 until 1994. From 1969 to 1972, Dr. Brock was President of the Asphalt Division of CMI Corporation. He earned his Ph.D. degree in mechanical engineering from the Georgia Institute of Technology. Dr. Brock is the father of Benjamin G. Brock, President of Astec, Inc., and Dr. Brock and Thomas R. Campbell, Group Vice President - Mobile Asphalt Paving and Underground, are first cousins. He is 68.

J. Neal Ferry

, was appointed Executive Vice President of the Company in January 2005 and assumed the additional role of Group V.P.-Aggregate and Mining in June 2006. In addition to these responsibilities he was also appointed Chief Operating Officer of the company effective January 1, 2007. Prior to this, he was employed by Peter Kiewit Sons', Inc. since 1971. Mr. Ferry was Corporate Equipment Manager for Kiewit from May 1996 until December 2004. During his career with Kiewit he held numerous positions in field operations, and corporate positions in Purchasing, Equipment Sales, and Equipment Maintenance Management. He is 54.

F. McKamy Hall

, a Certified Public Accountant, became Chief Financial Officer during 1998 and has served as Vice President and Treasurer since 1997. He previously served as Corporate Controller of the Company since 1987. Mr. Hall has an undergraduate degree in accounting and a Master of Business Administration degree from the University of Tennessee at Chattanooga. He is 64.

W. Norman Smith

was appointed Group Vice President-Asphalt in 1998 and additionally served as the President of Astec, Inc. from 1994 until October 2006. He formerly served as President of Heatec, Inc. from 1977 to 1994. From 1972 to 1977, Mr. Smith was a Regional Sales Manager with the Company. From 1969 to 1972, Mr. Smith was an engineer with the Asphalt Division of CMI Corporation. Mr. Smith has also served as a director of the Company since 1982. He is 67.

Thomas R. Campbell

was appointed Group Vice President - Mobile Asphalt Paving & Underground in November 2001. He served as President of Roadtec, Inc. from 1988 to 2004. He has served as President of Carlson Paving Products and American Augers since November 2001 until December 2006. He served as President of Astec Underground, Inc. from 2001 to May 2005. From 1981 to 1988, he served as Operations Manager of Roadtec. Mr. Campbell and J. Don Brock, President of the Company, are first cousins. He is 57.

Richard J. Dorris

was appointed President of Heatec, Inc. in April of 2004. From 1999 to 2004 he held the positions of National Accounts Manager, Project Manager and Director of Projects for Astec, Inc. Prior to joining Astec, Inc. he was President of Esstee Manufacturing Company from 1990 to 1999 and was Sales Engineer from 1984 to 1990. Mr. Dorris has a B.S. degree in mechanical engineering from the University of Tennessee. He is 46.

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Richard A. Patek

became President of Telsmith, Inc. in May of 2001. He served as President of Kolberg-Pioneer, Inc. from 1997 until May 2001. From 1995 to 1997, he served as Director of Materials of Telsmith, Inc. From 1992 to 1995, Mr. Patek was Director of Materials and Manufacturing of the former Milwaukee plant location. From 1978 to 1992, he held various manufacturing management positions at Telsmith. Mr. Patek is a graduate of the Milwaukee School of Engineering. He is 50.

Frank D. Cargould

became President of Breaker Technology Ltd. and Breaker Technology, Inc. on October 18, 1999. The Breaker Technology companies were formed on August 13, 1999 when the Company purchased substantially all of the assets of Teledyne Specialty Equipment's Construction and Mining business unit from Allegheny Teledyne Inc. From 1994 to 1999, he was Director of Sales - East for Teledyne CM Products, Inc. He is 64.

Jeffery J. Elliott

became President of Johnson Crushers, Inc. in December, 2001. From 1999 to 2001, he served as Senior Vice President for Cedarapids, Inc., (a Terex company), and from 1996 to 1999, he served as Vice President of the Crushing and Screening Group. From 1978 to 1996, he held various domestic and international sales and marketing positions with Cedarapids, Inc. He is 53.

Timothy Gonigam

was appointed President of Astec Mobile Screens, Inc., formerly Production Engineered Products, Inc., on October 1, 2000. From 1995 to 2000, Mr. Gonigam held the position of Sales Manager of Astec Mobile Screens, Inc. He is 44.

Tom Kruger

was appointed Managing Director of Osborn Engineered Products SA (Pty) Ltd. on February 1, 2005. For the previous five years, Mr. Kruger was employed as Operations Director of Macsteel Tube and Pipe (pty) Ltd., a manufacturer of carbon steel tubing in Johannesburg, South Africa. He served as Sales and Marketing Director of Macsteel prior to becoming Operations Director. From 1993 to 1998, Mr. Kruger was employed by Barloworld Ltd. as Operations Director and Regional Managing Director responsible for a trading organization in steel, tube and water conveyance systems. Prior to that, he held the position of Works Director. He is 49.

Joseph P. Vig

was appointed President of Kolberg-Pioneer, Inc. in May of 2001. From 1994 until May 2001, he served as Engineering Manager of Kolberg-Pioneer, Inc. From 1978 to 1993 he was Director of Engineering with Morgen Mfg. Co. Mr. Vig has a B.S. degree in civil engineering from the South Dakota School of Mines and Technology and is a Professional Engineer. He is 57.

Jeffrey L. Richmond

was appointed President of Roadtec, Inc. in April of 2004. From 1996 until April 2004, he held the positions of Sales Manager, Vice President of Sales and Marketing and Vice President/General Manager of Roadtec, Inc. He is 51.

Alan W. Odgers

was appointed President of Astec Underground, Inc. in May of 2005. From February 2004 to May 2005, he held the position of Vice President of Sales and Marketing of Astec Underground. From August 2002 until February 2004, he held the position of Managing Director of Vermeer International based in Europe. From January 2000 until August 2002, he held the position of Industrial Distribution Manager of Vermeer International. Mr. Odgers has a BBA degree from the University of Central Oklahoma. He is 59.

Michael A. Bremmer

was appointed President of CEI Enterprises, Inc. in January of 2006. From January 2003 until January 2006, he held the position of Vice President and General Manager of CEI Enterprises, Inc. From January 2001 until January 2003, he held the position of Director of Engineering of CEI Enterprises, Inc. He is 51.

Benjamin G. Brock

was appointed President of Astec, Inc. in November 2006. From January 2003 until October 2006 he held the position of Vice President - Sales of Astec, Inc. and Vice President/General Manager of CEI Enterprises, Inc. from 1997 until December 2002. Mr. Brock's career with Astec began as a salesman in 1993. Mr. Brock has a B.S. in Economics with a minor in Marketing from Clemson University. Mr. Brock is the son of J. Don Brock, President of the Company. He is 36.

David L. Winters

was appointed President of Carlson Paving Products effective January 1, 2007 after previously serving as its Vice President and General Manager from March 2002 until December 31, 2006. Mr. Winters also served as Quality Assurance Manager, Manufacturing Manager and Service Manager for Roadtec from August 1997 to February 2002. From 1977 to 1997 he held various positions in maintenance management with the Tennessee Valley Authority. Mr. Winters is 57.

James F. Pfeiffer

was appointed President of American Augers, Inc. effective January 1, 2007 after previously serving as its Vice President and General Manager from March 2005 until December 31, 2006. Prior to joining Astec, Mr. Pfeiffer was Vice President and General Manager of Daedong USA from April 2004 to October 2004 and Vice President of Marketing for Blount, Inc. from April 2002 to April 2004. Previously he held numerous positions with Charles Machine Works over a nineteen year period. Mr. Pfeiffer holds a bachelors degree in Agriculture from Oklahoma State University. Mr. Pfeiffer is 49.

Stephen C. Anderson

, was appointed Secretary of the Company in January 2007 and assumed the role of Director of Investor Relations in January 2003. He was Vice President of Astec Financial Services, Inc. from November 1999 to December 2002. Prior to this Mr. Anderson spent a combined fourteen years in Commercial Banking with AmSouth and SunTrust Banks. He has an B.S. degree in Business Management from the University of Tennessee at Chattanooga and is a graduate of the Stonier Graduate School of Banking. He is 43.

David C. Silvius

, a Certified Public Accountant, became Corporate Controller in 2005. He previously served as Corporate Financial Analyst since 1999. Mr. Silvius earned his undergraduate degree in accounting from Tennessee Technological University and his Masters of Business Administration from the University of Tennessee at Chattanooga. He is 39.

PART II

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Item 5

. Market for Registrant's Common Equity; Related Shareholder Matters and Issuer's Purchases of Equity Securities

The Company's Common Stock is traded in the Nasdaq National Market under the symbol "ASTE." The Company has never paid any cash dividends on its Common Stock and the Company does not intend to pay dividends on its Common Stock in the foreseeable future.

The high and low sales prices of the Company's Common Stock as reported on the Nasdaq National Market for each quarter during the last two fiscal years are as follows:

<u>2006</u>	<u>Price Per Share</u>	
	<u>High</u>	<u>Low</u>
1st Quarter	\$39.61	\$29.31
2nd Quarter	\$42.25	\$27.68
3rd Quarter	\$34.76	\$19.95
4th Quarter	\$35.98	\$24.10

<u>2005</u>	<u>Price Per Share</u>	
	<u>High</u>	<u>Low</u>
1st Quarter	\$22.39	\$16.01
2nd Quarter	\$25.45	\$19.41
3rd Quarter	\$35.56	\$21.12
4th Quarter	\$34.16	\$23.72

As of February 23, 2007, there were approximately 3,400 holders of the Company's Common Stock.

We maintain the following option plans: (i) 1998 Long-term Incentive Plan, (ii) 1998 Non-Employee Director Stock Incentive Plan and (iii) Executive Officer Annual Bonus Equity Election Plan. We also maintain the 2006 Incentive Plan for the awarding of stock to key management based upon achieving profitability goals.

Item 6

. Selected Financial Data

Selected financial data appears in Appendix "A" of this Report.

Item 7

. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's discussion and analysis of financial condition and results of operations appears beginning in Appendix "A" of this Report.

Item 7A

. Quantitative and Qualitative Disclosures About Market Risk

Information appearing under the caption "Market Risk and Risk Management Policies" appears in Appendix "A" of this report.

Item 8

. Financial Statements and Supplementary Data

Financial statements and supplementary financial information appear beginning in Appendix "A" of this Report.

Item 9

. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A

. Controls and Procedures

Disclosure Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures" (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective in timely making known to them material information relating to the Company and the Company's subsidiaries required to be disclosed in the Company's reports filed or submitted under the Exchange Act.

Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f)/15d-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based upon that evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2006.

During the course of the Company's 2005 annual audit, significant deficiencies in internal controls primarily related to the adequacy of inventory controls, accounting system access controls, journal entry authorization, and monitoring

controls related to Astec Underground, Inc., a wholly owned subsidiary of the Company, were identified. When aggregated, these deficiencies represented a material weakness in the Company's internal controls over financial reporting. Management has taken numerous actions to remedy these significant deficiencies, including making improvements to the steel inventory control and reporting system; initiating additional and remedial training programs; hiring an inventory control specialist for Astec Underground, Inc.; implementing new journal entry review and documentation procedures; and hiring a new controller for Astec Underground, Inc. These enhancements in controls have been in place for several months and have been tested by our management. Based upon these remedial actions and the results of its testing performed, our management has concluded that the Company has remedied the material weakness in our internal control over financial reporting identified in the prior year.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 has been audited by Ernst & Young LLP, an independent registered public accounting firm. Ernst & Young has issued an attestation report on management's assessment of the Company's internal control over financial reporting. The report is included herein.

Other Control Matters

Except as described above, there have been no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-a5(f) under the Securities Exchange Act of 1934, as amended) that occurred during the quarter ended December 31, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B

. Other Information

None.

PART III

Item 10

. Directors, Executive Officers and Corporate Governance

Information regarding the Company's directors, executive officers, director nominating process, audit committee, and audit committee financial expert is included under the captions "Election of Directors - Certain Information Concerning Nominees and Directors" and "Corporate Governance" in the Company's definitive Proxy Statement to be delivered to the shareholders of the Company in connection with the Annual Meeting of Shareholders to be held on May 1, 2007, which is incorporated herein by reference. Information regarding compliance with Section 16(a) of the Exchange Act is also included under "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive Proxy Statement, which is incorporated herein by reference.

The Company's Board of Directors has approved a Code of Conduct and Ethics that applies to the Company's employees, directors and officers (including the Company's principal executive officer, principal financial officer and principal accounting officer). The Code of Conduct and Ethics is available on the Company's website at www.astecindustries.com/investors/.

Item 11**. Executive Compensation**

Information included under the captions "Executive Compensation", "Compensation Committee Interlocks and Insider Participation" and "Report of the Compensation Committee" in the Company's definitive Proxy Statement to be delivered to the shareholders of the Company in connection with the Annual Meeting of Shareholders to be held on May 1, 2007 is incorporated herein by reference.

Item 12**. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters**

Information included under the captions "Election of Directors - Certain Information Concerning Nominees and Directors," "Common Stock Ownership of Management" and "Common Stock Ownership of Certain Beneficial Owners" in the Company's definitive Proxy Statement to be delivered to the shareholders of the Company in connection with the Annual Meeting of Shareholders to be held on May 1, 2007 is incorporated herein by reference.

Equity Compensation Plan Information

The following table provides information about the Common Stock that may be issued under all of the Company's existing equity compensation plans as of December 31, 2006.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity Compensation Plans Approved by Shareholders	1,193,316 ⁽¹⁾ 7,228 ⁽²⁾	\$22.63 \$26.13	13,809 283,108
Equity Compensation Plans Not Approved by Shareholders	16,665 ⁽³⁾	\$17.37	151,682
Total	1,217,209	\$22.58	448,599

1. 1998 Long-term Incentive Plan
2. Executive Officer Annual Bonus Equity Election Plan
3. 1998 Non-Employee Director Stock Incentive Plan

Equity Compensation Plans Not Approved by Shareholders

Our 1998 Non-Employee Directors Stock Incentive Plan provides that annual retainers payable to our non-employee directors will be paid in the form of cash, unless the director elects to receive the annual retainer in the form of Common Stock, deferred stock or stock options. If the director elects to receive Common Stock, whether on a current or deferred basis, the number of shares to be received is determined by dividing the dollar value of the annual retainer by the fair market value of the Common Stock on the date the retainer is payable. If the director elects to receive stock options, the number of options to be received is determined by dividing the dollar value of the annual retainer by the Black-Scholes value of an option on the date the retainer is payable.

Item 13

. Certain Relationships and Related Transactions, and Director Independence

Information included under the captions "Corporate Governance: Independent Directors" and "Transactions with Related Persons" in the Company's definitive Proxy Statement to be delivered to the shareholders of the Company in connection with the Annual Meeting of Shareholders to be held on May 1, 2007 is incorporated herein by reference.

Item 14

. Principal Accounting Fees and Services

Information included under the caption "Audit Matters" in the Company's definitive Proxy Statement to be delivered to the shareholders of the Company in connection with the Annual Meeting of Shareholders to be held on May 1, 2007 is incorporated herein by reference.

PART IV

Item 15

. Exhibits and Financial Statement Schedules

(a)(1) The following financial statements and other information appear in Appendix "A" to this Report and are filed as a part hereof:

Selected Consolidated Financial Data.

Management's Discussion and Analysis of Financial Condition and Results of Operations.

Reports of Independent Registered Public Accounting Firms.

Consolidated Balance Sheets at December 31, 2006 and 2005.

Consolidated Statements of Operations for the Years Ended December 31, 2006, 2005 and 2004.

Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004.

Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 2006, 2005 and 2004.

Notes to Consolidated Financial Statements.

(a)(2) Other than as described below, Financial Statement Schedules are not filed with this Report because the Schedules are either inapplicable or the required information is presented in the Financial Statements or Notes thereto. The following Schedule appears in Appendix "A" to this Report and is filed as a part hereof:

Schedule II - Valuation and Qualifying Accounts.

(a)(3) The following Exhibits* are incorporated by reference into or are filed with this Report:

3.1

Restated
Charter of the
Company
(incorporated
by reference
from the
Company's
Registration

Statement on Form S-1, effective June 18, 1986, File No. 33-5348).

3.2

Articles of Amendment to the Restated Charter of the Company, effective September 12, 1988 (incorporated by reference from the Company's Annual Report on Form 10-K for the year ended December 31, 1988, File No. 0-14714).

3.3

Articles of Amendment to the Restated Charter of the Company, effective June 8, 1989 (incorporated by reference from the Company's Annual Report on Form 10-K for the year ended December 31, 1989, File No. 0-14714).

Closing, the Company shall issue a press release announcing the consummation of the transactions contemplated by this Agreement at such Closing, and on or before 5:30 p.m. New York City time on the fourth business day after each Closing, the Company shall file a Current Report on Form 8-K attaching such press release. The Company shall not, and shall cause each of its officers, directors, employees, and use its best efforts to cause its agents, not to, provide the Purchaser with any material nonpublic information regarding the Company from and after the filing of the 8-K Filing without the express written consent of the Purchaser. The Company understands and confirms that the Purchaser will rely on the representations and covenants set forth in this section in effecting transactions in securities of the Company.

4.26 Use of Purchaser Name. Except as may be required by applicable law or regulation, the Company shall not use the Purchaser's name or the name of any of its affiliates in any advertisement, announcement, press release or other similar public communication unless it has received the prior written consent of the Purchaser for the specific use contemplated or as otherwise required by applicable law or regulation.

4.27 Related Party Transactions. No transaction has occurred between or among the Company, any of the Subsidiaries and their affiliates, officers or directors or any affiliate or affiliates of any such officer or director that is required to have been described under applicable securities laws in the Company's Exchange Act filings and is not so described in such filings.

4.28 Off-Balance Sheet Arrangements. There is no transaction, arrangement or other relationship between the Company and an unconsolidated or other off-balance sheet entity that is required to be disclosed by the Company in the Company's Exchange Act filings and is not so disclosed or that otherwise would be reasonably likely to have a Material Adverse Effect. There are no such transactions, arrangements or other relationships with the Company that may create contingencies or liabilities that are not otherwise disclosed by the Company in the Company's Exchange Act filings.

4.29 Governmental Permits, Etc. Each of the Company and its Subsidiaries has all franchises, licenses, certificates and other authorizations from such federal, state or local government or governmental agency, department or body that are currently required for the operation of the business of the Company and its Subsidiaries as currently conducted, except where the failure to possess currently such franchises, licenses, certificates and other authorizations is not reasonably expected to have a Material Adverse Effect. The Company and its Subsidiaries have not received any notice of proceedings relating to the revocation or modification of any such permit which, if the subject of an unfavorable decision, ruling or finding, could reasonably be expected to have a Material Adverse Effect.

4.30 Financial Statements. The consolidated financial statements of the Company and the related notes contained in the Company's last quarterly report on Form 10-QSB present fairly, in accordance with generally accepted accounting principles, the consolidated financial position of the Company and its Subsidiaries as of the dates indicated, and the results of their operations, cash flows and the changes in stockholders' equity for the periods therein specified, subject, in the case of unaudited financial statements for interim periods, to normal year-end audit adjustments. Such consolidated financial statements (including the related notes) have been prepared in accordance with generally accepted accounting principles applied on a consistent basis throughout the periods therein specified, except that unaudited financial statements may not contain all footnotes required by generally accepted accounting principles.

4.31 Intentionally deleted.

4.32 Sarbanes-Oxley Act. The Company is, and at each Closing Date will be, in compliance in all material respects with all provisions of the Sarbanes-Oxley Act of 2002 which are applicable to it. The Company maintains a system of internal accounting controls that the Company reasonably believes are sufficient to provide reasonable assurance that (i) transactions are executed in accordance with management's general or specific authorization; and (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and to maintain accountability for assets.

4.33 Listing. The Company has not, in the two years preceding the date hereof, received any notice (written or oral) from the American Stock Exchange, any stock exchange, market or trading facility on which the Common Stock is or has been listed (or on which it has been quoted) to the effect that the Company is not in compliance with the listing or maintenance requirements of such exchange, market or trading facility. The Company shall comply with all requirements of the American Stock Exchange with respect to the issuance of the Securities and shall use its best efforts to have the Securities listed on the American Stock Exchange prior to applicable Closing Date.

4.34 Foreign Corrupt Practices. Neither the Company, nor any of its Subsidiaries, nor, to the knowledge of the Company, any director, officer, agent, employee or other person acting on behalf of the Company or any of its Subsidiaries has, in the course of its actions for, or on behalf of, the Company (i) used any corporate funds for any unlawful contribution, gift, entertainment or other unlawful expenses relating to political activity; (ii) made any direct or indirect unlawful payment to any foreign or domestic government official or employee from corporate funds; (iii) violated or is in violation of any provision of the U.S. Foreign Corrupt Practices Act of 1977, as amended; or (iv) made any unlawful bribe, rebate, payoff, influence payment, kickback or other unlawful payment to any foreign or domestic government official or employee.

4.35 Employee Relations. Neither the Company nor any of its Subsidiaries is a party to any collective bargaining agreement or employs any member of a union. No executive officer of the Company (as defined in Rule 501(f) of the Securities Act) has notified the Company that such officer intends to leave the Company or otherwise terminate such officer's employment with the Company. No executive officer of the Company, to the knowledge of the

Company, is, or is now expected to be, in violation of any material term of any employment contract, confidentiality, disclosure or proprietary information agreement, non-competition agreement, or any other contract or agreement or any restrictive covenant, and the continued employment of each such executive officer does not subject the Company or any of its Subsidiaries to any liability with respect to any of the foregoing matters.

4.36 ERISA. The Company is in compliance, in all material respects, with all presently applicable provisions of the Employee Retirement Income Security Act of 1974, as amended, including the regulations and published interpretations thereunder (ERISA); no reportable event (as defined in ERISA) has occurred with respect to any pension plan (as defined in ERISA) for which the Company would have any liability; the Company has not incurred and does not expect to incur liability under (i) Title (IV) of ERISA with respect to termination of, or withdrawal from, any pension plan or (ii) Sections 412 or 4917 of the Internal Revenue Code of 1986, as amended, including the regulations and published interpretations thereunder (the Code); and each pension plan for which the Company would have any liability that is intended to be qualified under Section 401(a) of the Code is so qualified in all material respects and nothing has occurred, whether by action or by failure to act, which, in each case, would cause the loss of such qualification, except as would not reasonably be expected to have a Material Adverse Effect.

4.37 Environmental Matters. There has been no storage, disposal, generation, manufacture, transportation, handling or treatment of toxic wastes, hazardous wastes or hazardous substances by the Company or to its knowledge, any of its Subsidiaries (or, to the knowledge of the Company, any of their predecessors in interest) at, upon or from any of the property now or previously owned or leased by the Company or any of its Subsidiaries in violation of any applicable law, ordinance, rule, regulation, order, judgment, decree or permit or which would require remedial action under any applicable law, ordinance, rule, regulation, order, judgment, decree or permit; there has been no material spill, discharge, leak, emission, injection, escape, dumping or release of any kind into such property or into the environment surrounding such property of any toxic wastes, medical wastes, solid wastes, hazardous wastes or hazardous substances due to or caused by the Company or any of its Subsidiaries or with respect to which the Company or any of its Subsidiaries have knowledge; the terms hazardous wastes , toxic wastes , hazardous substances , and medical wastes shall have the meanings specified in any applicable local, state, federal and foreign laws or regulations with respect to environmental protection.

4.38 Removal of Legend. The legend set forth in Section 5(f) shall be removed from the certificates evidencing the Securities (i) following any sale of such Securities pursuant to Rule 144 or at the written request of a Purchaser after the Registration Statement has been declared effective, (ii) if such Securities are eligible for sale under Rule 144(k) (and the holder of such Securities has submitted a written request for removal of the legend indicating that the holder has complied with the applicable provisions of Rule 144 or such judicial interpretation or pronouncement), or (iii) if such legend is not required under applicable requirements of the Securities Act (including judicial interpretations and pronouncements issued by the Staff of the Commission) and the holder of such Securities has submitted a written request for removal of the legend indicating that such legend is not required under applicable requirements of the Securities Act (including such judicial interpretations and pronouncements issued by the Staff of the

Commission). The Company shall cause its counsel to issue a legal opinion to the Company's transfer agent promptly upon the occurrence of any of the events in clauses (i), (ii) or (iii) above to effect the removal of the legend on certificates evidencing the Securities and shall also cause its counsel to issue a blanket legal opinion to the Company's transfer agent promptly after the effective date of any registration statement covering the resale of the Securities, if required by the Company's transfer agent, to allow sales without restriction pursuant to an effective registration statement. The Company agrees that at such time as such legend is no longer required under this Section 4.38, it will, no later than five (5) business days (or three (3) business days in the event the Purchaser needs to deliver unlegended certificates in connection with settlement of a sale of Securities and such Purchaser has communicated such settlement date in writing to the Company) following the delivery by the Purchaser to the Company or the Company's transfer agent of a certificate representing the Securities issued with a restrictive legend, deliver or cause to be delivered to such Purchaser a certificate representing such Securities that is free from all restrictive and other legends; provided that in the case of removal of the legend for reasons set forth in clause (ii) above, the holder of such Securities has submitted a written request for removal of the legend indicating that the holder has complied with the applicable provisions of Rule 144. The Company may not make any notation on its records or give instructions to any transfer agent of the Company that enlarge the restrictions on transfer set forth in this Section 4.38.

SECTION 5. Representations, Warranties and Covenants of the Purchaser. (a) The Purchaser represents and warrants to, and covenants with, the Company that: (i) the Purchaser is knowledgeable, sophisticated and experienced in making, and is qualified to make, decisions with respect to investments in shares representing an investment decision like that involved in the purchase of the Securities, including investments in securities issued by the Company and comparable entities, and has had the opportunity to request, receive, review and consider all information it deems relevant in making an informed decision to purchase the Securities; (ii) the Purchaser is acquiring the number of Securities set forth on the signature page hereto in the ordinary course of its business and for its own account for investment only and with no present intention of distributing any of the Securities or any arrangement or understanding with any other persons regarding the distribution of any of the Securities (this representation and warranty notwithstanding, such Purchaser does not agree to hold any of the Securities for any minimum or other specific term and this representation and warranty does not limit the Purchaser's right to sell pursuant to the Registration Statement or in compliance with the Securities Act and the Rules and Regulations, or, other than with respect to any claims arising out of a breach of this representation and warranty, the Purchaser's right to indemnification under Section 7.3); (iii) the Purchaser will not, directly or indirectly, offer, sell, pledge, transfer or otherwise dispose of (or solicit any offers to buy, purchase or otherwise acquire or take a pledge of) any of the Securities except in compliance with the Securities Act and the Rules and Regulations and any applicable state securities laws, nor has the Purchaser, during the last thirty (30) days prior to the date of this Agreement, directly or indirectly, effected or agreed to effect any transactions in the securities of the Company, including any short sale, whether or not against the box, established any put equivalent position (as defined in Rule 16a-1(h) under the Exchange Act) with respect to the Common Stock, granted any other right (including, without limitation, any put or call option) with respect to the Common Stock or with respect to any security that includes, relates to or derived any significant part of its value from the Common Stock or otherwise sought to hedge its position in the Securities (each, a Prohibited Transaction), and such Purchaser shall not

engage, directly or indirectly, in a Prohibited Transaction during the period from the date of this Agreement until such time as (A) the transactions contemplated by this Agreement are first publicly announced or (B) this Agreement is terminated pursuant to Section 21 hereof; (iv) the Purchaser has completed or caused to be completed the Registration Statement Questionnaire attached hereto as part of Appendix II, for use in preparation of the Registration Statement, and the answers thereto are true and correct as of the date hereof and will be true and correct as of the effective date of the Registration Statement and the Purchaser will notify the Company immediately of any material change in any such information provided in the Registration Statement Questionnaire until such time as the Purchaser has sold all of the Securities or until the Company is no longer required to keep the Registration Statement effective; (v) the Purchaser has, in connection with its decision to purchase the number of shares of Common Stock and Warrants set forth on the signature page hereto, relied solely upon the Company Documents as filed with the Commission and the documents included therein or incorporated by reference and the representations and warranties of the Company contained herein; (vi) the Purchaser has had an opportunity to discuss this investment with representatives of the Company and ask questions of them; (vii) the Purchaser is an accredited investor within the meaning of Rule 501(a) of Regulation D promulgated under the Securities Act ; and (viii) the Purchaser agrees to notify the Company immediately of any change in any of the foregoing information until such time as the Purchaser has sold all of the Securities or the Company is no longer required to keep the Registration Statement effective.

(b) The Purchaser understands that the Securities are being offered and sold to it in reliance upon specific exemptions from the registration requirements of the Securities Act, the Rules and Regulations and state securities laws and that the Company is relying upon the truth and accuracy of, and the Purchaser's compliance with, the representations, warranties, agreements, acknowledgments and understandings of the Purchaser set forth herein in order to determine the availability of such exemptions and the eligibility of the Purchaser to acquire the Securities.

(c) For the benefit of the Company, the Purchaser previously agreed orally with the Placement Agent to keep confidential all information concerning the private placement of the Securities to the Purchaser. The Purchaser understands that the existence and nature of all conversations and presentations, if any, regarding the Company and this offering must be kept strictly confidential. The Purchaser understands that the federal securities laws impose restrictions on trading based on information regarding the offering of the Securities to the Purchaser. In addition, the Purchaser hereby acknowledges that unauthorized disclosure of information regarding the offering of the Securities to the Purchaser may result in a violation of Regulation FD. This obligation will terminate upon submission by the Company of the 8-K Filing. In addition to the above, the Purchaser shall maintain in confidence the receipt and content of any notice of a Suspension (as defined in Section 5(h) below). The foregoing agreements shall not apply to any information that is or becomes publicly available through no fault of the Purchaser, or that the Purchaser is legally required to disclose; provided, however, that if the Purchaser is requested or ordered to disclose any such information pursuant to any court or other government order or any other applicable legal procedure, it shall provide the Company with prompt notice of any such request or order in time sufficient to enable the Company to seek (at its own expense) an appropriate protective order.

(d) The Purchaser understands that its investment in the Securities involves a significant degree of risk, including a risk of total loss of the Purchaser's investment, and the Purchaser has full cognizance of and understands all of the risk factors related to the Purchaser's purchase of the Securities. The Purchaser understands that the market price of the Common Stock can be volatile and that no representation is being made as to the future value of the Common Stock. The Purchaser has the knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of an investment in the Securities and has the ability to bear the economic risks of an investment in the Securities.

(e) The Purchaser understands that no United States federal or state agency or any other government or governmental agency has passed upon or made any recommendation or endorsement of the Securities.

(f) The Purchaser understands that, until such time as the Registration Statement has been declared effective or the Securities may be sold pursuant to Rule 144 under the Securities Act without any restriction as to the number of securities as of a particular date that can then be immediately sold, the Securities will bear a restrictive legend in substantially the following form:

The Securities evidenced by this certificate have not been registered under the Securities Act of 1933, as amended (the Securities Act), or the securities laws of any state or other jurisdiction. The Securities may not be offered, sold, pledged or otherwise transferred except (1) pursuant to an exemption from registration under the Securities Act or (2) pursuant to an effective registration statement under the Securities Act, in each case in accordance with all applicable securities laws of the states and other jurisdictions, and in the case of a transaction exempt from registration, unless the Company has received an opinion of counsel reasonably satisfactory to it that such transaction does not require registration under the Securities Act and such other applicable laws.

(g) The Purchaser's principal executive offices are in the jurisdiction set forth immediately below the Purchaser's name on the signature pages hereto.

(h) The Purchaser hereby covenants with the Company not to make any sale of the Securities under the Registration Statement without complying with the provisions of this Agreement and without effectively causing the prospectus delivery requirement under the Securities Act to be satisfied to the extent applicable, and the Purchaser acknowledges and agrees that the Securities are not transferable on the books of the Company in connection with any sale under the Registration Statement unless the certificate submitted to the transfer agent evidencing the Securities is accompanied by a separate Purchaser's Certificate of Subsequent Sale delivered by the Purchaser: (i) in the form of Appendix III hereto, (ii) executed by an officer of, or other authorized person designated by, the Purchaser, and (iii) to the effect that (A) the Securities have been sold in accordance with the Registration Statement, the Securities Act and any applicable state securities or blue sky laws and (B) the requirement of

delivering a current prospectus has been satisfied, to the extent applicable. Purchaser will notify the Company promptly after the sale of all of the Securities. Purchaser acknowledges that there may occasionally be times when the Company, in the good faith determination of its Board of Directors, but if not practical under the circumstances in the good faith determination of the Company's executive officers, must suspend the use of the Prospectus forming a part of the Registration Statement (a "Suspension") until such time as an amendment to the Registration Statement has been filed by the Company and declared effective by the Commission, or until such time as the Company has filed an appropriate report with the Commission pursuant to the Exchange Act. The Purchaser hereby covenants that it will not sell any of the Securities pursuant to said Prospectus during the period commencing at the time at which the Company gives the Purchaser written notice of the Suspension of the use of said Prospectus and ending at the time the Company gives the Purchaser written notice that the Purchaser may thereafter effect sales pursuant to said Prospectus. Notwithstanding the foregoing, the Company agrees that no Suspension shall be for a period of longer than 60 consecutive days, and no Suspension shall be for a period of an aggregate in any 365-day period of longer than 90 days.

(i) The Purchaser further represents and warrants to, and covenants with, the Company that (i) the Purchaser has full right, power, authority and capacity to enter into this Agreement and to consummate the transactions contemplated hereby and has taken all necessary action to authorize the execution, delivery and performance of this Agreement, (ii) the making and performance of this Agreement by the Purchaser and the consummation of the transactions herein contemplated will not violate any provision of the organizational documents of the Purchaser or conflict with, result in the breach or violation of, or constitute, either by itself or upon notice or the passage of time or both, a default under any material agreement, mortgage, deed of trust, lease, franchise, license, indenture, permit or other instrument to which the Purchaser is a party, or any statute or any authorization, judgment, decree, order, rule or regulation of any court or any regulatory body, administrative agency or other governmental body applicable to the Purchaser, (iii) no consent, approval, authorization or other order of any court, regulatory body, administrative agency or other governmental body is required on the part of the Purchaser for the execution and delivery of this Agreement or the consummation of the transactions contemplated by this Agreement, (iv) upon the execution and delivery of this Agreement, this Agreement shall constitute a legal, valid and binding obligation of the Purchaser, enforceable in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' and contracting parties' rights generally and except as enforceability may be subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law) and except to the extent enforcement of the indemnification provisions, set forth in Section 7.3 of this Agreement, may be limited by federal or state securities laws or the public policy underlying such laws, and (v) there is not in effect any order enjoining or restraining the Purchaser from entering into or engaging in any of the transactions contemplated by this Agreement.

SECTION 6. Survival of Representations, Warranties and Agreements. Notwithstanding any investigation made by any party to this Agreement or by the Placement Agent, all covenants, agreements, representations and warranties made by the Company and the Purchaser herein and in the certificates for the Securities delivered pursuant hereto shall survive

the execution of this Agreement, the delivery to the Purchaser of the Securities being purchased and the payment therefore.

SECTION 7. Registration of the Securities: Compliance with the Securities Act.

7.1 Registration Procedures and Expenses. The Company shall:

(a) as soon as reasonably practicable, but in no event later than five (5) days following the Second Closing Date, or if the Second Closing shall not have taken place, within 45 days after the Initial Closing Date, then in no event later than 45 days after the Initial Closing Date (such date, Filing Date), prepare and file with the Commission the Registration Statement on Form S-3 relating to the sale of the Securities by the Purchaser, as well as any shares of Common Stock issued or issuable upon any stock split, dividend or other distribution, recapitalization or other similar event with respect to the Securities (such shares together with the Securities are collectively referred to as, the Shares) from time to time on the American Stock Exchange, or the facilities of any national securities exchange on which the Common Stock is then traded or in privately-negotiated transactions (the parties acknowledge that the Company may choose to include the Shares on a registration statement with other similar securities issued by the Company);

(b) use its best efforts, subject to receipt of necessary information from the Purchaser, to cause the Commission to declare the Registration Statement effective within 45 days after the Filing Date (such date, the Required Effective Date). However, so long as the Company filed the Registration Statement by the Filing Date, if the Registration Statement receives Commission review, then the Required Effective Date will be the seventy-fifth (75th) calendar day after the Filing Date;

(c) use its best efforts to promptly prepare and file with the Commission such amendments and supplements to the Registration Statement and the prospectus used in connection therewith as may be necessary to keep the Registration Statement effective until the earliest of (i) two years after the effective date of the Registration Statement, or (ii) such time as the Shares become eligible for resale by non-affiliates pursuant to Rule 144(k) under the Securities Act of 1933, as amended;

(d) promptly furnish to the Purchaser with respect to the Shares registered under the Registration Statement (and to each underwriter, if any, of such Shares) such number of copies of prospectuses and such other documents as the Purchaser may reasonably request, in order to facilitate the public sale or other disposition of all or any of the Shares by the Purchaser;

(e) file documents required of the Company for normal Blue Sky clearance in states specified in writing by the Purchaser; provided, however, that the Company shall not be required to qualify to do business or consent to service of process in any jurisdiction in which it is not now so qualified or has not so consented;

(f) bear all expenses in connection with the procedures in paragraphs (a) through (e) of this Section 7.1 and the registration of the Shares pursuant to the Registration

Statement, other than fees and expenses, if any, of counsel or other advisers to the Purchaser or underwriting discounts, brokerage fees and commissions incurred by the Purchaser, if any;

(g) file a Form D with respect to the Securities as required under Regulation D and to provide a copy thereof to the Purchaser promptly after filing;

(h) issue a press release describing the transactions contemplated by this Agreement on each of the Closing Dates;

(i) make available, while the Registration Statement is effective and available for resale, its Chief Executive Officer, Chief Financial Officer, and Chief Administrative Officer for questions regarding information which the Purchaser may reasonably request in order to fulfill any due diligence obligation on its part; and

(j) promptly provide to the Purchaser notice of (i) effectiveness of the Registration Statement, (ii) any Suspension, or (iii) the issuance of any stop order with respect to the Registration Statement.

The Company understands that the Purchaser disclaims being an underwriter, but the Purchaser being deemed an underwriter shall not relieve the Company of any obligations it has hereunder. A questionnaire related to the Registration Statement to be completed by the Purchaser is attached hereto as Appendix II.

7.2 Transfer of Securities After Registration. The Purchaser agrees that it will not effect any disposition of the Securities or its right to purchase the Securities that would constitute a sale within the meaning of the Securities Act or any applicable state securities laws, except as contemplated in the Registration Statement referred to in Section 7.1 or as otherwise permitted by law, and that it will promptly notify the Company of any changes in the information set forth in the Registration Statement regarding the Purchaser or its plan of distribution. Notwithstanding anything contained in this Agreement to the contrary, it is expressly understood and agreed that (i) the number of Shares set forth in the Registration Statement shall decrease by virtue of sales of the Shares by the Purchaser, (ii) the Purchaser shall have no obligation to inform the Company of such sales or any changes to the number of Shares set forth in the Registration Statement, the Prospectus or any supplement or update to either of them and (iii) the Purchaser shall have no liability whatsoever for failing to inform the Company of any such sales or changes to the number of Shares set forth in the Registration Statement, the Prospectus or any supplement or update to either of them; provided, however, that if the Company notifies the Purchaser of its intent to amend the Registration Statement, and the Company shall request from the Purchaser in such notice an update to the information in the Registration Statement, the Purchaser shall provide to the Company any changes to the information set forth in the Registration Statement.

7.3 Indemnification. For the purpose of this Section 7.3:

(i) the term Purchaser/Affiliate shall mean any affiliate of the Purchaser, including a transferee who is an affiliate of the Purchaser, and any person who controls the Purchaser or any

affiliate of the Purchaser within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act; and

(ii) the term Registration Statement shall include any preliminary prospectus, final prospectus, exhibit, supplement or amendment included in or relating to, and any document incorporated by reference in, the Registration Statement referred to in Section 7.1.

(a) The Company agrees to indemnify and hold harmless the Purchaser and each Purchaser/Affiliate against any losses, claims, damages, liabilities or expenses, joint or several, to which the Purchaser or any Purchaser/Affiliate may become subject, under the Securities Act, the Exchange Act, or any other federal or state statutory law or regulation, or at common law or otherwise (including in settlement of any litigation, if such settlement is effected with the prior written consent of the Company), insofar as such losses, claims, damages, liabilities or expenses (or actions in respect thereof as contemplated below) arise out of or are based upon any untrue statement or alleged untrue statement of any material fact contained in the Registration Statement, including the Prospectus, financial statements and schedules, and all other documents filed as a part thereof, as amended at the time of effectiveness of the Registration Statement, including any information deemed to be a part thereof as of the time of effectiveness pursuant to paragraph (b) of Rule 430A, or pursuant to Rule 434, of the Rules and Regulations, or the Prospectus, in the form first filed with the Commission pursuant to Rule 424(b) of the Regulations, or filed as part of the Registration Statement at the time of effectiveness if no Rule 424(b) filing is required, or any amendment or supplement thereto, or arise out of or are based upon the omission or alleged omission to state in any of them a material fact required to be stated therein or necessary to make the statements in any of them, in light of the circumstances under which they were made, not misleading, or arise out of or are based in whole or in part on any inaccuracy in the representations or warranties of the Company contained in this Agreement, or any failure of the Company to perform its obligations hereunder or under law, and will promptly reimburse the Purchaser and each Purchaser/Affiliate for any legal and other expenses as such expenses are reasonably incurred by the Purchaser or any Purchaser/Affiliate in connection with investigating, defending or preparing to defend, settling, compromising or paying any such loss, claim, damage, liability, expense or action; provided, however, that the Company will not be liable in any such case to the extent, but only to the extent, that any such loss, claim, damage, liability or expense arises out of or is based upon (i) an untrue statement or alleged untrue statement or omission or alleged omission made in the Registration Statement, the Prospectus or any amendment or supplement thereto in reliance upon and in conformity with written information furnished to the Company by or on behalf of the Purchaser expressly for use therein, or (ii) the failure of the Purchaser to comply with the covenants and agreements contained in Sections 5 or 7.2, or (iii) the inaccuracy of any representation or warranty made by the Purchaser herein or (iv) any statement or omission in any Prospectus that is corrected in any subsequent Prospectus that was delivered to the Purchaser prior to the pertinent sale or sales by the Purchaser.

(b) The Purchaser will severally indemnify and hold harmless the Company, each of its directors, each of its executive officers, including such officers who signed the Registration Statement, and each person, if any, who controls the Company within the

meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act in an amount not to exceed in the aggregate for all indemnification obligations arising pursuant to Section 7.3(b) the net proceeds received by the Purchaser from sales of Shares under the Registration Statement, against any losses, claims, damages, liabilities or expenses to which the Company, each of its directors, each of its officers who signed the Registration Statement or controlling person may become subject, under the Securities Act, the Exchange Act, or any other federal or state statutory law or regulation, or at common law or otherwise (including in settlement of any litigation, if such settlement is effected with the written consent of the Purchaser) insofar as such losses, claims, damages, liabilities or expenses (or actions in respect thereof as contemplated below) arise out of or are based upon (i) any failure of the Purchaser to comply with its covenants and agreements contained in Sections 5 or 7.2 hereof, or (ii) any untrue or alleged untrue statement of any material fact contained in the Registration Statement, the Prospectus, or any amendment or supplement thereto, or arise out of or are based upon the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, in each case to the extent, but only to the extent, that such untrue statement or alleged untrue statement or omission or alleged omission was made in the Registration Statement, the Prospectus, or any amendment or supplement thereto, in reliance upon and in conformity with written information furnished to the Company by or on behalf of the Purchaser expressly for use therein, and will reimburse the Company, each of its directors, each of its officers who signed the Registration Statement or controlling person for any legal and other expense reasonably incurred by the Company, each of its directors, each of its officers who signed the Registration Statement or controlling person in connection with investigating, defending, settling, compromising or paying any such loss, claim, damage, liability, expense or action.

(c) Promptly after receipt by an indemnified party under this Section 7.3 of notice of the threat or commencement of any action, such indemnified party will, if a claim in respect thereof is to be made against an indemnifying party under this Section 7.3, promptly notify the indemnifying party in writing thereof; but the omission so to notify the indemnifying party will not relieve it from any liability which it may have to any indemnified party for contribution or otherwise under the indemnity agreement contained in this Section 7.3 to the extent it is not prejudiced as a result of such failure. In case any such action is brought against any indemnified party and such indemnified party seeks or intends to seek indemnity from an indemnifying party, the indemnifying party will be entitled to participate in, and, to the extent that it may wish, jointly with all other indemnifying parties similarly notified, to assume the defense thereof with counsel reasonably satisfactory to such indemnified party; provided, however, if the defendants in any such action include both the indemnified party and the indemnifying party and the indemnified party shall have reasonably concluded, based on an opinion of counsel reasonably satisfactory to the indemnifying party, that there may be a conflict of interest between the positions of the indemnifying party and the indemnified party in conducting the defense of any such action or that there may be legal defenses available to it and/or other indemnified parties which are different from or additional to those available to the indemnifying party, the indemnified party or parties shall have the right to select separate counsel to assume such legal defenses and to otherwise participate in the defense of such action on behalf of such indemnified party or parties. Upon receipt of notice from the indemnifying party to such indemnified party of its election to assume the defense of such action and approval by the indemnified party of counsel, the indemnifying party will not be liable to such

indemnified party under this Section 7.3 for any legal or other expenses subsequently incurred by such indemnified party in connection with the defense thereof unless (i) the indemnified party shall have employed such counsel in connection with the assumption of legal defenses in accordance with the proviso to the preceding sentence (it being understood, however, that the indemnifying party shall not be liable for the expenses of more than one separate counsel, reasonably satisfactory to such indemnifying party, representing all of the indemnified parties who are parties to such action) or (ii) the indemnifying party shall not have employed counsel reasonably satisfactory to the indemnified party to represent the indemnified party within a reasonable time after notice of commencement of action, in each of which cases the reasonable fees and expenses of counsel shall be at the expense of the indemnifying party. In no event shall any indemnifying party be liable in respect of any amounts paid in settlement of any action unless the indemnifying party shall have approved in writing the terms of such settlement; provided that such consent shall not be unreasonably withheld. No indemnifying party shall, without the prior written consent of the indemnified party, effect any settlement of any pending or threatened proceeding in respect of which any indemnified party is or could have been a party and indemnification could have been sought hereunder by such indemnified party from all liability on claims that are the subject matter of such proceeding.

(d) If the indemnification provided for in this Section 7.3 is required by its terms but is for any reason held to be unavailable to or otherwise insufficient to hold harmless an indemnified party under paragraphs (a), (b) or (c) of this Section 7.3 in respect to any losses, claims, damages, liabilities or expenses referred to herein, then each applicable indemnifying party shall contribute to the amount paid or payable by such indemnified party as a result of any losses, claims, damages, liabilities or expenses referred to herein (i) in such proportion as is appropriate to reflect the relative benefits received by the Company and the Purchaser from the private placement of the Securities to the Purchaser hereunder or (ii) if the allocation provided by clause (i) above is not permitted by applicable law, in such proportion as is appropriate to reflect not only the relative benefits referred to in clause (i) above but the relative fault of the Company and the Purchaser in connection with the statements or omissions or inaccuracies in the representations and warranties in this Agreement and/or the Registration Statement which resulted in such losses, claims, damages, liabilities or expenses, as well as any other relevant equitable considerations; provided, however, that the Purchaser shall only be required to contribute an amount up to the net proceeds received by the Purchaser from sales of the Shares under the Registration Statement. The respective relative benefits received by the Company on the one hand and the Purchaser on the other shall be deemed to be in the same proportion as the amount paid by the Purchaser to the Company pursuant to this Agreement for the Shares purchased by the Purchaser that were sold pursuant to the Registration Statement bears to the difference (the Difference) between the amount the Purchaser paid for the Shares that were sold pursuant to the Registration Statement and the amount received by the Purchaser from such sale. The relative fault of the Company, on the one hand, and the Purchaser on the other shall be determined by reference to, among other things, whether the untrue or alleged statement of a material fact or the omission or alleged omission to state a material fact or the inaccurate or the alleged inaccurate representation and/or warranty relates to information supplied by the Company or by the Purchaser and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission. The amount paid or payable by a party as a result of the losses, claims, damages, liabilities and expenses referred to above shall be deemed to include, subject to the limitations set forth in paragraph (c) of this Section 7.3, any legal or other fees

or expenses reasonably incurred by such party in connection with investigating or defending any action or claim. The provisions set forth in paragraph (c)

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of this Section 7.3 with respect to the notice of the threat or commencement of any threat or action shall apply if a claim for contribution is to be made under this paragraph (d); provided, however, that no additional notice shall be required with respect to any threat or action for which notice has been given under paragraph (c) for purposes of indemnification. The Company and the Purchaser agree that it would not be just and equitable if contribution pursuant to this Section 7.3 were determined solely by pro rata allocation (even if the Purchaser were treated as one entity for such purpose) or by any other method of allocation which does not take account of the equitable considerations referred to in this paragraph. Notwithstanding the provisions of this Section 7.3, the Purchaser shall not be required to contribute any amount in excess of the amount by which the Difference exceeds the amount of any damages that the Purchaser has otherwise been required to pay by reason of such untrue or alleged untrue statement or omission or alleged omission. No person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation. The Purchaser's obligation to contribute pursuant to this Section 7.3 is several and not joint.

7.4 Termination of Conditions and Obligations. The restrictions imposed by Section 5 or this Section 7 upon the transferability of the Securities shall cease and terminate as to any particular number of the Securities upon the passage of two years from the effective date of the Registration Statement covering the Securities or at such time as an opinion of counsel satisfactory in form and substance to the Company shall have been rendered to the effect that such conditions are not necessary in order to comply with the Securities Act.

7.5 Information Available. So long as the Registration Statement is effective covering the resale of the Shares owned by the Purchaser, the Company will furnish to the Purchaser:

(a) as soon as practicable after available (but in the case of the Annual Report to the Stockholders, within 150 days after the end of each fiscal year of the Company), one copy of (i) its Annual Report to Stockholders (which Annual Report shall contain financial statements audited in accordance with generally accepted accounting principles by a national firm of certified public accountants), (ii) if not included in substance in the Annual Report to Stockholders, upon the request of Purchaser, its Annual Report on Form 10-K, (iii) upon request of Purchaser, its quarterly reports on Form 10-Q, and (iv) a full copy of the particular Registration Statement covering the Shares (the foregoing, in each case, excluding exhibits);

(b) upon the reasonable request of the Purchaser, a reasonable number of copies of the Prospectuses, and any supplements thereto, to supply to any other party requiring such Prospectuses; and

(c) the Company, upon the reasonable request of the Purchaser and with prior notice, will be available to the Purchaser or a representative thereof at the Company's headquarters to discuss information relevant for disclosure in the Registration Statement covering the Shares and will otherwise cooperate with the Purchaser conducting an investigation for the purpose of reducing or eliminating the Purchaser's exposure to liability under the

Securities Act, including the reasonable production of information at the Company's headquarters, subject to appropriate confidentiality limitations.

7.6 Delay in Filing or Effectiveness of Registration Statement. If (i) the Registration Statement is not filed by the Company with the Commission on or prior to the Filing Date, then for each day following the Filing Date, until but excluding the date the Registration Statement is filed, or (ii) the Registration Statement is not declared effective by the Commission by the Required Effective Date, then for each day following the Required Effective Date, until but excluding the date the Commission declares the Registration Statement effective, in each case, the Company shall, for each such day, pay the Purchaser with respect to any such failure, as partial damages and not as a penalty, an amount equal to 0.0667% of the purchase price paid by the Purchaser for the Securities pursuant to this Agreement; and for any such day, such payment shall be made no later than the first business day of the calendar month next succeeding the month in which such day occurs. If the Purchaser shall be prohibited from selling any of the Shares under the Registration Statement as a result of a Suspension of more than thirty (30) days or Suspensions on more than two (2) occasions of not more than thirty (30) days each in any 12-month period, then for each day on which a Suspension is in effect that exceeds the maximum allowed period above for a Suspension or Suspensions, but not including any day on which a Suspension is lifted, the Company shall pay the Purchaser, as partial damages and not as a penalty, an amount equal to 0.0667% of the purchase price paid by the Purchaser for the Securities purchased pursuant to this Agreement for each such day, and such payment shall be made no later than the first business day of the calendar month next succeeding the month in which such day occurs. For purposes of this Section 7.6, a Suspension shall be deemed lifted on the date that notice that the Suspension has been lifted is delivered to the Purchaser pursuant to Section 11 of this Agreement. Any payments made pursuant to this Section 7.6. shall not constitute the Purchaser's exclusive remedy for such events. Notwithstanding the foregoing provisions, in no event shall the Company be obligated to pay such partial damages to more than one person in respect of the same Securities for the same period of time. Such payments shall be made to the Purchaser in cash.

SECTION 8. Certain Adjustments. (a) Subject to Section 8(c), except with respect to the issuance of Excluded Securities (as such term is defined in the Warrant), if at any time on or before the one year anniversary of the Second Closing (the Full Ratchet Period), the Company shall issue or sell or agree to issue or sell any shares of Common Stock or Common Stock Equivalents (as defined below) to any person or persons for a price per share (in each case, as determined in accordance with Section 2.8 of the Warrant) less than the Strike Price (as defined below) in effect immediately prior to the time of such issue or sale or agreement related thereto, then and in each such case (a Trigger Issuance), the Company shall issue without the payment of additional consideration, in connection with such Trigger Issuance, a number of additional shares of Common Stock to the Purchaser equal to difference of: (A) the number of shares of Common Stock that would have been issued to such Purchaser, based on such Purchaser's purchase price of Common Stock at the Initial Closing (i.e., \$5.25 per share), if the Strike Price in effect immediately prior to such Trigger Issuance was equal to the Strike Price in effect immediately after such Trigger Issuance; minus (B) the number of shares of Common Stock initially issued to such Purchaser upon payment of its purchase price (and, to the extent there has been a previous adjustment to the price per share, any Anti-Dilution Shares previously issued to such Purchaser).

(b) Subject to Section 8(c), except with respect to the issuance of Excluded Securities, if at any time after the Full Ratchet Period, the Company shall effect a Trigger Issuance, the Company shall issue without the payment of additional consideration, in connection with such Trigger Issuance, a number of additional shares of Common Stock to the Purchaser equal to the difference of: (A) the number of shares of Common Stock that would have been issued to such Purchaser at each Closing that occurred under this Agreement, if the price per share for such Purchaser was equal to the product of the Strike Price in effect immediately prior to such Trigger Issuance multiplied by a fraction, the numerator of which shall be the number of shares of Common Stock outstanding immediately prior to such Trigger Issuance plus the number of shares of Common Stock which the aggregate consideration received by the Company for the total number of additional shares of Common Stock so issued in the Trigger Issuance would purchase at the purchase price paid by the Purchaser at the Initial Closing (i.e., \$5.25), and the denominator of which shall be the number of shares of Common Stock outstanding immediately prior to such Trigger Issuance plus the number of such additional shares of Common Stock so issued; minus (B) the number of shares of Common Stock initially issued to such Purchaser upon payment of its purchase price (and, to the extent there has been a previous adjustment to the price per share, any Anti-Dilution Shares previously issued to such Purchaser).

(c) The provisions of this Section 8(c) shall be applicable to Sections 8(a) and 8(b) and to Section 9. The price per share at which the Company issues or sells or agrees to issue or sell shares of Common Stock or Common Stock Equivalents shall be determined in accordance with the provisions of Section 2.8 of the Warrant. For the avoidance of doubt, the issuance of Common Stock Equivalents (and not the actual conversion or exercise of such Common Stock Equivalent into shares of Common Stock) is the event that gives rise to the issuance of Anti-Dilution Shares pursuant to this Section 8. Promptly following the occurrence of any event giving rise to the issuance of any Anti-Dilution Shares (but in no event more than four (4) business days thereafter), the Company shall issue irrevocable instructions authorizing its transfer agent to issue such Anti-Dilution Shares to the Purchaser. Without further action or deed, automatically after each Trigger Issuance, the Strike Price shall be reset to the per share price at which the Common Stock, or the Common Stock underlying the Common Stock Equivalents, was issued in the Trigger Issuance; as determined in accordance with the provisions of Section 2.8 of the Warrant. The Strike Price shall initially be equal to \$5.25, and shall be re-set from time to time in accordance with the immediately preceding sentence upon each Trigger Issuance. Notwithstanding the foregoing, Sections 8(a) and 8(b) and Section 9 shall not apply to the issuance of Excluded Securities.

SECTION 9. Participation Right on Future Financings.

(a) **Notice of Proposed Issuance.** Except with respect to the issuance of Excluded Securities or Common Stock and Common Stock Equivalents to Strategic Investors (as defined below) of the Company, in the event that the Company proposes to issue any (i) shares of Common Stock, (ii) warrants, options or other rights to purchase shares of Common Stock or (iii) any notes, debentures or other securities convertible into or exercisable or exchangeable for shares of Common Stock (collectively, the Common Stock Equivalents), the Company will deliver to the Purchaser a written notice (the Offer Notice) prior to effecting any such issuance (the New Issuance), offering to such Purchaser the right, for a period of ten (10)

days, to purchase for cash at an amount equal to the price or other consideration for which such Common Stock or Common Stock Equivalents are to be issued, on a pro rata basis with all other purchasers of Securities at the Initial Closing who then own such Securities (each, a Recipient), a number of shares of such Common Stock or Common Stock Equivalents equal to the lesser of (i) the number of shares to be issued in such New Issuance equal to the number of shares of Common Stock or Common Stock Equivalents, as the case may be, that could be purchased for the aggregate purchase price paid at the Initial Closing and the Second Closing, and (ii) twenty percent (20.0%) of the number of shares of Common Stock or Common Stock Equivalents, as the case may be, to be issued in such New Issuance. The Offer Notice shall describe the securities proposed to be issued by the Company and specify the number, price and payment terms in the New Issuance.

(b) Right to Purchase Common Stock or Common Stock Equivalents.

(i) The Purchaser may accept the Company's offer as to the full number of securities offered to it in the Offer Notice or any lesser number, by written notice thereof (an Exercise Notice) given by it to the Company prior to the expiration of the aforesaid 10-day period. A delivery of an Exercise Notice (which notice shall specify the number (or amount) of Common Stock Equivalents to be purchased by the Purchaser as permitted under this Section 9) shall constitute a binding agreement of the holder to purchase, at the price and on the terms specified in the Offer Notice, the number (or amount) of Common Stock or Common Stock Equivalents specified in the Purchaser's Exercise Notice. If at the termination of such 10-day period the Purchaser shall not have exercised its rights to purchase Common Stock or Common Stock Equivalents pursuant to this Section 9, the Purchaser shall be deemed to have waived any and all of its rights under this Section 9 with respect to that purchase of such Common Stock or Common Stock Equivalents (such waiver shall not apply to any subsequently offered Common Stock or Common Stock Equivalents). Notwithstanding anything in this Section 9 to the contrary, if, with respect to a given New Issuance, any other Recipient elects not to exercise fully its rights or is deemed to have waived its rights, then the Company shall provide the Purchaser and each other Recipient who exercised its rights with a second Offer Notice, and the Purchaser and each other Recipient who exercised its rights may include in its Exercise Notice for such New Issuance, upon delivery to the Company of an Exercise Notice within five (5) business days after receipt by the Purchaser and each other Recipient of such second Offer Notice, an additional number (or amount) of Common Stock or Common Stock Equivalents equal to its pro rata share of the unexercised number (or amount) of Common Stock or Common Stock Equivalents in such New Issuance.

(ii) The Company shall have ninety (90) days from the date of the Offer Notice to consummate the proposed New Issuance at the price and upon substantially the same terms specified in the Offer Notice, provided that, if such issuance is subject to regulatory and shareholder approval, such ninety (90) day period shall be extended until the expiration of five (5) business days after all such approvals have been received, but in no event later than one hundred eighty (180) days from the date of the Offer Notice. At the consummation of such New Issuance, the Company shall issue certificates representing the Common Stock or Common Stock Equivalents to be purchased by the Purchaser registered in the name of such Purchaser, against payment by such Purchaser of the purchase price for such Common Stock or Common Stock Equivalents specified in such Purchaser's Exercise Notice. If

the Company proposed to issue any class of Common Stock or Common Stock Equivalents after such time period above, it shall again comply with the procedures set forth in this Section 9.

(iii) The value of any non-cash consideration to be received by the Company in any New Issuance shall be determined by the Board of Directors in good faith, and shall be specified in the Offer Notice delivered in connection with any such New Issuance. If the Purchaser elects to exercise its rights under this Section 9 in connection with any New Issuance in which there is any such non-cash consideration, then, such Purchaser may elect in its Exercise Notice to tender, in lieu of tendering any such non-cash consideration, an amount in cash equal to the reasonably determined good faith value of such non-cash consideration.

(c) Expiration of Participation Right. The participation right granted pursuant to this Section 9 shall expire on the two (2) year anniversary of the date of this Agreement. For purposes of this Section 9, the term Strategic Investor means (i) any person that has been resolved by a majority of a quorum of the Company's Board of Directors to constitute a strategic investor on the basis of such person's (A) existing or prospective business relationship with the Company and/or its subsidiaries; or (B) existing or anticipated ability to further the business objectives of the Company and/or its subsidiaries; or (ii) a corporation, partnership or other entity that has at the time of its initial investment in the Company (A) an equity market capitalization in excess of \$100 million or (B) assets in excess of \$100 million.

SECTION 10. Broker's Fee. The Purchaser acknowledges that the Company intends to pay to the Placement Agent a fee in respect of the sale of the Securities to the Purchaser. The Purchaser and the Company hereby agree that the Purchaser shall not be responsible for such fee and that the Company will indemnify and hold harmless the Purchaser and each Purchaser/Affiliate against any losses, claims, damages, liabilities or expenses, joint or several, to which the Purchaser or any Purchaser/Affiliate may become subject with respect to such fee. Each of the parties hereto hereby represents that, on the basis of any actions and agreements by it, there are no other brokers or finders entitled to compensation in connection with the sale of the Securities to the Purchaser.

SECTION 11. Notices. All notices required or permitted hereunder shall be in writing and shall be deemed effectively given: (i) upon delivery to the party to be notified; (ii) when received by confirmed facsimile or (iii) one (1) business day after deposit with a nationally recognized overnight carrier, specifying next business day delivery, with written verification of receipt. All communications shall be sent to the Company and the Purchaser as follows or at such other addresses as the Company or the Purchaser may designate upon ten (10) days advance written notice to the other party:

- (a) if to the Company, to:

Sunair Services Corporation.
3005 SW Third Avenue
Fort Lauderdale, Florida 33315
Facsimile: (561) 955-7333
Attention:

with a copy to:

Akerman Senterfitt
One Southeast Third Avenue, 28th
Floor
Miami, Florida 33131
Facsimile: (305) 374-5618
Attention: Stephen K. Roddenberry

- (b) if to the Placement Agent, to:

Roth Capital Partners, LLC
11100 Santa Monica Blvd.
Suite 550
Los Angeles, California 90025
Facsimile: (310) 445-5864
Attention: John Dalfonsi

with a copy to:

Lowenstein Sandler PC
1251 Avenue of the Americas
New York, New York 10020
Facsimile: (973) 597-2507
Attention: Steven E. Siesser

- (c) if to the Purchaser, at its address as
set forth at the end of this
Agreement.

SECTION 12. Changes. This Agreement may not be modified or amended except pursuant to an instrument in writing signed by the Company and the Purchaser. No provision hereunder may be waived other than in a written instrument executed by the waiving party.

SECTION 13. Headings. The headings of the various sections of this Agreement have been inserted for convenience of reference only and shall not be deemed to be part of this Agreement.

SECTION 14. Severability. In case any provision contained in this Agreement should be invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained herein shall not in any way be affected or impaired thereby.

SECTION 15. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of New York and the federal law of the United States of America.

SECTION 16. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall constitute an original, but all of which, when taken together, shall constitute but one instrument, and shall become effective when one or more counterparts have been signed by each party hereto and delivered to the other parties. In the event that any signature is delivered by facsimile transmission or by an e-mail which contains an electronic file of an executed signature page, such signature shall create a valid and binding obligation of the party executing (or on whose behalf such signature is executed) with the same force and effect as if such facsimile or electronic file signature page (as the case may be) were an original thereof.

SECTION 17. Entire Agreement. This Agreement and the instruments referenced herein contain the entire understanding of the parties with respect to the matters covered herein and therein and, except as specifically set forth herein or therein, neither the Company nor the Purchaser makes any representation, warranty, covenant or undertaking with respect to such matters.

SECTION 18. Assignment. Except as otherwise expressly provided herein, the provisions hereof shall inure to the benefit of, and be binding upon, the parties hereto and their respective permitted successors, assigns, heirs, executors and administrators. This Agreement and the rights of the Purchaser hereunder may be assigned by the Purchaser with the prior written consent of the Company, except such consent shall not be required in cases of assignments by an investment adviser to a fund for which it is the adviser or by or among funds that are under common control, provided that such assignee agrees to be bound by the terms of this Agreement.

SECTION 19. Further Assurances. Each party agrees to cooperate fully with the other parties and to execute such further instruments, documents and agreements and to give such further written assurance as may be reasonably requested by any other party to evidence and reflect the transactions described herein and contemplated hereby and to carry into effect the intents and purposes of this Agreement.

SECTION 20. Independent Nature of the Purchaser's Obligations and Rights. The obligations of the Purchaser under this Agreement are several and not joint with the obligations of any other third party purchasers of the Company's securities, and the Purchaser shall not be responsible in any way for the performance of the obligations of any other third party purchasers of the Company's securities. Each of the Purchaser and the Company agree and acknowledge that (i) the decision of the Purchaser to purchase the Securities pursuant to this Agreement has been made by the Purchaser independently of any other third party purchasers of the Company's securities and (ii) no other third party purchasers of the Company's securities have acted as agent for the Purchaser in connection with the Purchaser making its investment hereunder and that no such other third party purchasers will be acting as agent of the Purchaser in connection with monitoring its investment hereunder or enforcing its rights under this Agreement. Nothing contained herein or in any other document contemplated hereby or any agreement of any such other third party purchaser, and no action taken by the Purchaser pursuant hereto or any other third party purchaser pursuant thereto, shall be deemed to constitute the Purchaser or any such

other third party purchasers as a partnership, an association, a joint venture or any other kind of entity, or create a presumption that the Purchaser or any such other third party purchasers are in any way acting in concert or as a group with respect to any matters. The Purchaser shall be entitled to independently protect and enforce its rights, including, without limitation, the rights arising out of this Agreement or out of any of the other documents contemplated hereby, and it shall not be necessary for any such other third party purchasers to be joined as an additional party in any proceeding for such purpose. To the extent that any such other third party purchasers purchase the same or similar securities as the Purchaser hereunder or on the same or similar terms and conditions or pursuant to the same or similar documents, all such matters are solely in the control of the Company, not the action or decision of the Purchaser, and would be solely for the convenience of the Company and not because it was required or requested to do so by the Purchaser or any such other third party purchaser.

SECTION 21. Termination. Purchaser may terminate this Agreement without any obligation or liability hereunder or otherwise if the Initial Closing does not occur within fifteen (15) business days after the execution of this Agreement. After the Initial Closing, Purchaser may also terminate this Agreement, but only with respect to the Second Closing and the Additional Securities to be purchased by the Purchaser, without any obligation or liability hereunder or otherwise if the Second Closing does not occur within forty-five (45) days after the Initial Closing, and in such event all applicable sections and provisions of this Agreement shall survive such termination.

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IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their duly authorized representatives as of the day and year first above written.

SUNAIR SERVICES
CORPORATION

By:

Name:

Title:

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[Investor Signature Page]

Print or Type:

Name of Purchaser
(Individual or Institution):

Name of Individual representing
Purchaser (if an Institution):

Title of Individual representing
Purchaser (if an Institution):

Signature by:

Individual Purchaser or Individual
representing Purchaser:

Address:

Telephone:

Telecopier:

Number of Securities to Be Purchased by the Purchaser at the Initial Closing	Price Per Share In Dollars	Aggregate Price to be paid by the Purchaser at Initial Closing	Number of Securities to be Purchased by the Purchaser at the Second Closing	Price Per Share In Dollars	Aggregate Price to be paid by the Purchaser at Second Closing
--	-------------------------------------	---	--	--	--

Common Stock	\$	Common Stock	\$	\$
Warrants		Warrants		

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**ANNEX B
FORM OF WARRANT**

Warrant No. _____

The securities represented by this certificate have been acquired directly or indirectly from the Issuer without being registered under the Securities Act of 1933, as amended (the Securities Act), or any other applicable securities laws, and are restricted securities as that term is defined under Rule 144 promulgated under the Securities Act. These securities may not be sold, pledged, transferred, distributed or otherwise disposed of in any manner (Transfer) unless they are registered under the Securities Act and any other applicable securities laws, or unless the request for Transfer is accompanied by a favorable opinion of counsel, reasonably satisfactory to the Issuer, stating that the Transfer will not result in a violation of the Securities Act or any other applicable securities laws.

WARRANT

SUNAIR SERVICES CORPORATION

SUNAIR SERVICES CORPORATION (formerly known as Sunair Electronics, Inc.) (the Issuer), a Florida corporation, with offices at 3005 SW^d Ave., Fort Lauderdale, FL 33315-3312, for value received, hereby certifies as of _____, 2005 (the Issuance Date) that _____, a _____ (Investor), with an address for notice purposes hereunder at _____,

_____, or its registered assigns, is entitled to purchase from the Issuer up to _____ (_____) (as further defined below, the Issuable Number) duly authorized, validly issued, fully paid and non-assessable shares (subject to the adjustments contained in this Warrant) of common stock, par value \$0.10 per share (the Common Stock), of the Issuer at the purchase price per share equal to Six Dollars and Thirty Cents (\$6.30) (the Exercise Price) at any time and from time to time on or after _____, 2006 which date which is one hundred eighty (180) days from the Issuance Date (the Exercise Date) and at or before 5:00 p.m., Fort Lauderdale, Florida time, on the fifth anniversary of the Issuance Date (the Termination Date), all subject to the terms, conditions and adjustments set forth below in this Warrant. Capitalized terms used herein are defined in Section 10 hereof or elsewhere throughout this Warrant, or in that certain Purchase Agreement, dated as of _____, 2005, by and between Issuer and Investor (the Purchase Agreement). For purposes of this Warrant, the Issuable Number shall equal thirty-five percent (35%) of the aggregate number of shares of Common Stock purchased by Investor at the Closing pursuant to the Purchase Agreement at which this Warrant was issued.

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1. Exercise of Warrant.

1.1 Manner of Exercise. This Warrant may be exercised by the holder of this Warrant (the Holder) in whole or in part, at any time and from time to time on or after the Exercise Date, by facsimile, mail or overnight courier delivery of a notice in substantially the form attached to this Warrant (or a reasonable facsimile thereof) duly executed by such Holder (a Warrant Exercise Notice). The closing of each exercise shall take place on (i) the third (3rd) Business Day following, and excluding, the date the Warrant Exercise Notice is delivered (the Warrant Notice Date), subject to the provisions of Section 1.4(b) hereof, (ii) at the option of the Holder, such later date as the conditions set forth in Section 1.2 have been waived or satisfied or (iii) any other date upon which the exercising Holder and the Issuer mutually agree (each, a Warrant Closing Date).

(a) This Warrant may be exercised by the Holder hereof by paying cash to Issuer in the amount equal to the product of (i) the number of shares of Common Stock for which the Warrant is being exercised (without giving effect to any adjustment thereof) multiplied by (ii) the Exercise Price.

(b) In lieu of payment of the Exercise Price in cash as set forth in Section 1.1(a), the Holder hereof may exercise this Warrant by specifying in the Warrant Exercise Notice that such Holder has elected to exercise this Warrant pursuant to a broker-assisted exercise/sale procedure pursuant to which funds to pay for exercise of the Warrant are delivered to the Issuer by a broker upon receipt of stock certificates from the Issuer through a licensed broker reasonably acceptable to the Issuer whereby the stock certificate or certificates for the shares of Common Stock for which the Warrant is exercised will be delivered by the Issuer to such broker as the agent for the Holder exercising the Warrant and the broker will deliver to the Issuer cash (or cash equivalents acceptable to the Issuer) equal to the Exercise Price for the shares of Common Stock purchased pursuant to the exercise of the Warrant. The Issuer shall allow the issuance and delivery to such broker of the shares of Common Stock necessary to effect the sale of such shares by such broker and apply the sales proceeds to pay the Exercise Price notwithstanding the fact that the Issuer will not receive the cash proceeds until after the sale of the underlying shares of Common Stock, subject, in the event the Holder is an officer or director of the Issuer, to compliance with the applicable provisions of the Sarbanes-Oxley Act of 2002 with respect to loans to officers and directors. Holder hereby expressly agrees to indemnify and to hold the Issuer harmless for the full amount of any loss or damage (including all reasonable trial attorneys' and appellate attorneys' fees including those which may be incurred in the enforcement of this indemnity) Issuer may sustain as a result of such broker failing to remit to Issuer the proceeds from the sale of such shares of Common Stock in accordance with this Section 1.1(b).

1.2 Conditions to Closing. It shall be a condition of the exercising Holder's obligation to close on each Warrant Closing Date that each of the following is satisfied, unless waived by such Holder:

(a) all shares to be issued upon such exercise shall be freely tradable Common Stock under the Securities Act and shall be duly listed and admitted to trading on Nasdaq,

the New York Stock Exchange or the American Stock Exchange, depending on where such shares are traded at the time the Warrant is exercised (unless the Holder expressly consents in writing to the issuance of unregistered Common Stock for a portion or all of the shares to be issued upon such exercise in which case the Issuer shall issue such unregistered Common Stock upon such request).

(b) As of such Warrant Closing Date, the Issuer shall have notified the Holder of all Restatements. The Holder and the Issuer expressly acknowledge and agree that the issuance of a press release by the Issuer disclosing a Restatement shall be deemed sufficient to satisfy this notice requirement.

If any such condition is not satisfied or waived prior to the third (3rd) Business Day following and excluding the date the Warrant Exercise Notice is delivered, then the Holder may, at its sole option, and at any time, withdraw the Warrant Exercise Notice by written notice to the Issuer regardless of whether such condition has been satisfied or waived as of the withdrawal date and, after such withdrawal, shall have no further obligation with respect to such Warrant Exercise Notice and may submit a Warrant Exercise Notice on any future date with respect to the shares referenced in the original Warrant Exercise Notice.

1.3 When Exercise Effective. Each exercise of this Warrant shall be deemed to have been effected immediately prior to 5:00 p.m. (time in effect in Fort Lauderdale, Florida on such date) on the Business Day on which the Warrant Exercise Notice is delivered as provided in Section 1.1, and at such time the Person or Persons in whose name or names any certificate or certificates for shares of Common Stock (or Other Securities) shall be issuable upon such exercise as provided in Section 1.4 shall be deemed to have become the Holder or Holders of record thereof, provided, however, that such exercise shall not be deemed effective if at or prior to 5:00 p.m. (time in effect in Fort Lauderdale, Florida on such date) on the Warrant Closing Date the Holder delivers written notice of withdrawal to the Issuer as set forth in Section 1.2.

1.4 Delivery of Warrant and Payment. On each Warrant Closing Date, the registered Holder shall surrender this Warrant to the Issuer at the address set forth for the Issuer in the introductory paragraph of this Warrant or such other address as the Issuer advises the Holder in writing and (a) shall deliver payment in cash, by wire transfer to the Issuer's account designated by Issuer of immediately available funds or by certified or official bank check payable to the order of the Issuer, to the extent that the Warrant is exercised in accordance with Section 1.1(a), shall have so specified in the Warrant Exercise Notice delivered by such Holder and such Holder shall thereupon be entitled to receive the number of duly authorized, validly issued, fully paid and nonassessable shares of Common Stock (or Other Securities) determined as provided in Sections 2 and 3 hereof, or (b) if exercising this Warrant in accordance with Section 1.1(b) above, shall have so specified in the Warrant Exercise Notice delivered by such Holder, and the Issuer shall deliver to the Holder's broker the number of duly authorized, validly issued, fully paid and nonassessable shares of Common Stock (or Other Securities) determined as provided in Sections 2 and 3 hereof, following the sale of which in accordance with Section 1.1(b) above such broker shall, within three (3) Business Days after the Warrant Closing Date, deliver payment in cash, by wire transfer to the Issuer's account designated by Issuer of immediately available funds or by certified or official bank check payable to the order of the Issuer, to the extent that the Warrant is exercised.

1.5 Delivery of Stock Certificates, etc. On each Warrant Closing Date, the Issuer at its expense (including the payment by it of any applicable issue taxes) shall cause to be issued in the name of and delivered to the Holder hereof or as such Holder may direct,

(a) via facsimile and at such address specified by the Holder via a reputable overnight courier, a delivery notice in the form of Exhibit 2 hereto and one or more certificates for the number of duly authorized, validly issued, fully paid and nonassessable shares of Common Stock (or Other Securities) to which such Holder shall be entitled upon such exercise plus, in lieu of any fractional share to which such Holder would otherwise be entitled, cash in an amount equal to the same fraction of the Closing Sales Price per share on the Business Day immediately preceding the date of such exercise, and

(b) in case such exercise is in part only, at such address specified by the Holder via reputable overnight courier, a new Warrant of like tenor, calling in the aggregate on the face or faces thereof for the number of shares of Common Stock equal (without giving effect to any adjustment thereof) to the number of such shares called for on the face of this Warrant minus the number of such shares designated by the Holder in the related Warrant Exercise Notice upon such exercise as provided in Section 1.1.

2. Adjustment of Common Stock Issuable Upon Exercise.

2.1 General: Warrant Price. The number of shares of Common Stock that the Holder of this Warrant shall be entitled to receive upon each exercise hereof shall be determined by multiplying the number of shares of Common Stock that would otherwise (but for the provisions of Sections 2 and 3) be issuable upon such exercise, as designated by the Holder hereof pursuant to Section 1.1, by a fraction of which (a) the numerator is the Exercise Price and (b) the denominator is the Warrant Price in effect on the date of such exercise. The Warrant Price shall initially be the Exercise Price. The Warrant Price shall be adjusted and readjusted from time to time as provided in Sections 2 and 3 hereof and, as so adjusted or readjusted, shall remain in effect until a further adjustment or readjustment thereof is required by Sections 2 and 3 hereof.

2.2 INTENTIONALLY LEFT BLANK.

2.3 INTENTIONALLY LEFT BLANK.

2.4 INTENTIONALLY LEFT BLANK.

2.5 Treatment of Stock Dividends, Stock Splits, etc. In case the Issuer at any time or from time to time on or after the Issuance Date shall declare or pay any dividend on the Common Stock payable in Common Stock, or shall effect a subdivision of the outstanding shares of Common Stock into a greater number of shares of Common Stock (by reclassification or otherwise than by payment of a dividend in Common Stock), then, and in each such case, the Warrant Price in effect immediately prior to such dividend or subdivision shall, concurrently with the deemed effectiveness of such dividend or subdivision, be reduced to a price determined by multiplying the Warrant Price by a fraction, the numerator of which shall be the number of shares of Common Stock outstanding immediately prior to giving effect to such dividend or subdivision and the denominator of which shall be the number of shares of Common Stock

outstanding immediately after giving effect to such dividend or subdivision (including, without limitation, all shares of Common Stock deemed issued or issuable in connection with or as a result of such dividend or subdivision notwithstanding that any such shares have not actually been issued as of the deemed effectiveness of such dividend or subdivision). For purposes hereof, such dividend or subdivision shall be deemed effective, and additional shares of Common Stock shall be deemed to have been issued pursuant thereto (a) in the case of any such dividend, immediately after the close of business on the record date for the determination of holders of any class of securities entitled to receive such dividend, or (b) in the case of any such subdivision, at the close of business on the day immediately prior to the day upon which such corporate action becomes effective.

2.6 Adjustments for Combinations, etc. In case the outstanding shares of Common Stock shall be combined or consolidated, by reclassification or otherwise, into a lesser number of shares of Common Stock, the Warrant Price in effect immediately prior to such combination or consolidation shall, concurrently with the effectiveness of such combination or consolidation, be proportionately increased.

2.7 Dividends and Distributions in Cash, Property or Securities other than Common Stock. In case the Issuer at any time or from time to time on or after the Issuance Date shall declare, order, pay or make a dividend or other distribution on the Common Stock of cash, property or securities (including, without limitation, a dividend payable in any shares, interests, rights, options, warrants, evidences of indebtedness or convertible securities of the Company or any other Person) other than a dividend payable in Common Stock covered under Section 2.5 hereof, then the Warrant Price shall be reduced, effective as of the date of such distribution record date, (a) in the case of a cash distribution, by the dollar amount of the cash distribution per share of Common Stock, subject to the last sentence of this Section 2.7, (b) in the case of a distribution of property other than cash, by the dollar amount of the fair market value of all the property being distributed divided by the number of shares of Common Stock issued and outstanding as of such dividend record date in respect of which such property distribution is being made and (c) in the case of a distribution of securities (including, without limitation, a dividend payable in any shares, interests, rights, options, warrants, evidences of indebtedness or convertible securities of the Company or any other Person) other than a dividend payable in Common Stock covered under Section 2.5 hereof, by the dollar amount of the fair market value of all such securities being distributed divided by the number of shares of Common Stock issued and outstanding as of such dividend record date in respect of which such property distribution is being made. The determination of fair market value of any such property (other than cash) or securities pursuant to this Section 2.7 shall be made by an independent, nationally recognized appraisal firm not affiliated with the Issuer that is regularly engaged in the business of appraising the type of property or securities, as applicable, that is the subject of such distribution, at the Issuer's expense. If the aggregate amount of any ordinary cash distributions from retained earnings lawfully made in accordance with Section 607.06401 of the Florida Business Corporation Act (expressly excluding, without limitation, extraordinary, liquidating or partial liquidating cash distributions, by way of return of capital or otherwise) ("Ordinary Cash Distributions") covered by this Section 2.7 shall, during any quarterly period of any calendar year (*i.e.* January 1 to March 31, April 1 to June 30, July 1 to September 30, or October 1 to December 31) (each, a "Quarterly Period"), total three-quarters of one percent (.75%) of the average of the Closing Sales Prices for the dividend record dates for such Ordinary Cash

Distributions during such Quarterly Period (the De Minimis Cash Distribution Amount) or less, then such cash distributions shall not require an adjustment to the Warrant Price pursuant to clause (a) of this Section 2.7; provided that, notwithstanding anything to the contrary set forth herein, the Warrant Price shall be adjusted as provided in clause (a) of this Section 2.7 by the aggregate amount of all (i) Ordinary Cash Distributions during any Quarterly Period in excess of the De Minimis Cash Distribution Amount and (ii) cash distributions other than Ordinary Cash Distributions.

2.8 Subsequent Equity Sales.

(a) Except as provided in Section 2.8(c) hereof, if and whenever the Company shall issue or sell, or is, in accordance with any of Sections 2.8(b)(i) through 2.8(b)(iv) hereof, deemed to have issued or sold, any Additional Shares of Common Stock for no consideration or for a consideration per share less than the Exercise Price in effect immediately prior to the time of such issue or sale, then and in each such case (a Trigger Issuance) the then-existing Exercise Price, shall be reduced, as of the close of business on the effective date of the Trigger Issuance, to a price determined as follows:

(i) if such Trigger Issuance occurs on or prior to the one year anniversary of the Issuance Date, the price of the Additional Shares of Common Stock issued in connection with the Trigger Issuance;

(ii) if such Trigger Issuance occurs after the one year anniversary of the Issuance Date, as follows:

$$\text{Adjusted Exercise Price} = \frac{(A \times B) + D}{A+C}$$

where

A equals the number of shares of Common Stock outstanding, including Additional Shares of Common Stock deemed to be issued hereunder, immediately preceding such Trigger Issuance;

B equals the Exercise Price in effect immediately preceding such Trigger Issuance;

C equals the number of Additional Shares of Common Stock issued or deemed issued hereunder as a result of the Trigger Issuance; and

D equals the aggregate consideration, if any, received or deemed to be received by the Company upon such Trigger Issuance;

provided, however, that in no event shall the Exercise Price after giving effect to such Trigger Issuance be (i) greater than the original Exercise Price; or (ii) less than \$_____ (the market price of the Company's Common Stock on the date of the Purchase Agreement), provided that the

foregoing clause (ii) shall not be applicable after the Company shall have obtained the requisite Stockholder Approval.

(b) For purposes of this Section 2.8, the following Sections 2.8(b)(i) through 2.8(b)(iv) shall also be applicable:

(i) Issuance of Rights or Options. In case at any time the Company shall in any manner grant (directly and not by assumption in a merger or otherwise) any Options or Convertible Securities, whether or not such Options or the right to convert or exchange any such Convertible Securities are immediately exercisable, and the price per share for which Common Stock is issuable upon the exercise of such Options or upon the conversion or exchange of such Convertible Securities (determined by dividing (i) the sum (which sum shall constitute the applicable consideration) of (x) the total amount, if any, received or receivable by the Company as consideration for the granting of such Options, plus (y) the aggregate amount of additional consideration payable to the Company upon the exercise of all such Options, plus (z), in the case of such Options which relate to Convertible Securities, the aggregate amount of additional consideration, if any, payable upon the issue or sale of such Convertible Securities and upon the conversion or exchange thereof, by (ii) the total maximum number of shares of Common Stock issuable upon the exercise of such Options or upon the conversion or exchange of all such Convertible Securities issuable upon the exercise of such Options) shall be less than the Exercise Price in effect immediately prior to the time of the granting of such Options, then the total number of shares of Common Stock issuable upon the exercise of such Options or upon conversion or exchange of the total amount of such Convertible Securities issuable upon the exercise of such Options shall be deemed to have been issued for such price per share as of the date of granting of such Options or the issuance of such Convertible Securities and thereafter shall be deemed to be outstanding for purposes of adjusting the Exercise Price. Except as otherwise provided in Section 2.8(b)(iii), no adjustment of the Exercise Price shall be made upon the actual issue of such Common Stock or of such Convertible Securities upon exercise of such Options or upon the actual issue of such Common Stock upon conversion or exchange of such Convertible Securities.

(ii) Issuance of Convertible Securities. In case the Company shall in any manner issue (directly and not by assumption in a merger or otherwise) or sell any Convertible Securities, whether or not the rights to exchange or convert any such Convertible Securities are immediately exercisable, and the price per share for which Common Stock is issuable upon such conversion or exchange (determined by dividing (i) the sum (which sum shall constitute the applicable consideration) of (x) the total amount received or receivable by the Company as consideration for the issue or sale of such Convertible Securities, plus (y) the aggregate amount of additional consideration, if any, payable to the Company upon the conversion or exchange thereof, by (ii) the total number of shares of Common Stock issuable upon the conversion or exchange of all such Convertible Securities) shall be less than the Exercise Price in effect immediately prior to the time of such issue or sale, then the total maximum number of shares of Common Stock issuable upon conversion or exchange of all such Convertible Securities shall be deemed to have been issued for such price per share as of the date of the issue or sale of such Convertible Securities and thereafter shall be deemed to be outstanding for purposes of adjusting the Exercise Price, provided that (a) except as otherwise provided in Section 2.8(b)(iii), no adjustment of the Exercise Price shall be made upon the actual issuance of such Common Stock upon conversion or exchange of such Convertible Securities and (b) no further adjustment of the

Exercise Price shall be made by reason of the issue or sale of Convertible Securities upon exercise of any Options to purchase any such Convertible Securities for which adjustments of the Exercise Price have been made pursuant to the other provisions of Section 2.8.

(iii) Change in Option Price or Conversion Rate. Upon the happening of any of the following events, namely, if the purchase price provided for in any Option referred to in Section 2.8(b)(i) hereof, the additional consideration, if any, payable upon the conversion or exchange of any Convertible Securities referred to in Sections 2.8(b)(i) or 2.8(b)(ii), or the rate at which Convertible Securities referred to in Sections 2.8(b)(i) or 2.8(b)(ii) are convertible into or exchangeable for Common Stock shall change at any time (including, but not limited to, changes under or by reason of provisions designed to protect against dilution), the Exercise Price in effect at the time of such event shall forthwith be readjusted to the Exercise Price which would have been in effect at such time had such Options or Convertible Securities still outstanding provided for such changed purchase price, additional consideration or conversion rate, as the case may be, at the time initially granted, issued or sold. On the termination of any Option for which any adjustment was made pursuant to this Section 2.8 or any right to convert or exchange Convertible Securities for which any adjustment was made pursuant to this Section 2.8 (including without limitation upon the redemption or purchase for consideration of such Convertible Securities by the Company), the Exercise Price then in effect hereunder shall forthwith be changed to the Exercise Price which would have been in effect at the time of such termination had such Option or Convertible Securities, to the extent outstanding immediately prior to such termination, never been issued.

(iv) Consideration for Stock. In case any shares of Common Stock, Options or Convertible Securities shall be issued or sold for cash, the consideration received therefor shall be deemed to be the gross amount received by the Company therefor. In case any shares of Common Stock, Options or Convertible Securities shall be issued or sold for a consideration other than cash, the amount of the consideration other than cash received by the Company shall be deemed to be the fair market value of such consideration as determined in good faith by the Board of Directors of the Company. In case any Options shall be issued in connection with the issue and sale of other securities of the Company, together comprising one integral transaction in which no specific consideration is allocated to such Options by the parties thereto, such Options shall be deemed to have been issued for such consideration as determined in good faith by the Board of Directors of the Company. If Common Stock, Options or Convertible Securities shall be issued or sold by the Company and, in connection therewith, other Options or Convertible Securities (the Additional Rights) are issued, then the consideration received or deemed to be received by the Company shall be reduced by the fair market value of the Additional Rights (as determined using the Black-Scholes option pricing model or another method mutually agreed to by the Company and the Holder). The Board of Directors of the Company shall respond promptly, in writing, to an inquiry by the Holder as to the fair market value of the Additional Rights or non-cash consideration. In the event that the Holder objects to the Board of Directors' determination of the fair market value of the Additional Rights or non-cash consideration (as the case may be), the Company and the Holder shall jointly select an appraiser, who is experienced in such matters. The decision of such appraiser shall be final and conclusive, and the cost of such appraiser shall be borne evenly by the Company and the Holder.

(c) Notwithstanding the foregoing, no adjustment will be made under this Section 2.8 in respect of the issuance of Excluded Securities.

3. Business Combinations.

3.1 Adjustment upon Business Combination. In case the Issuer on or after the Issuance Date is a party to (i) any acquisition of the Issuer by means of merger or other form of corporate reorganization in which outstanding shares of the Issuer are exchanged for securities or other consideration issued, or caused to be issued, by the Acquiring Person or its Parent, Subsidiary or affiliate, (ii) a sale of all or substantially all of the assets of the Issuer (on a consolidated basis) in a single transaction or series of related transactions, (iii) any other transaction or series of related transactions by the Issuer or relating to the Common Stock (including without limitation, any stock purchase or tender or exchange offer) in which the power to cast the majority of the eligible votes at a meeting of the Issuer's shareholders at which directors are elected is transferred to a single entity or group acting in concert, or (iv) a capital reorganization or reclassification of the Common Stock (other than a reorganization or reclassification in which the Common Stock are not converted into or exchanged for cash or other property, and, immediately after consummation of such transaction, the shareholders of the Issuer immediately prior to such transaction own the Common Stock or other voting stock of the Issuer in substantially the same proportions relative to each other as such shareholders owned immediately prior to such transaction), then, and in the case of each such transaction (each of which is referred to herein as Business Combination), proper provision shall be made so that, upon the basis and the terms and in the manner provided herein, the Holder, upon exercise of all or any part of this Warrant at any time after the consummation of such Business Combination, shall be entitled to receive upon such exercise, the Common Stock and Other Securities, cash and property to which the Holder would have been entitled upon such consummation if the Holder had exercised the Warrant immediately prior thereto (including, without limitation, any additional shares of Common Stock, Other Securities, cash and property issuable as a result of an increase in the Issuable Number occurring after the date of consummation of such Business Combination), as determined using the Black-Scholes option pricing model or another method mutually agreed to by the Company and the Holder; provided, that if the Acquiring Person or its Parent, as the case may be, shall combine, subdivide or reclassify its common stock, or shall declare any dividend payable in shares of its common stock, or shall take any other action of a similar nature affecting such shares, the calculations above shall be adjusted to the extent appropriate, as provided in Section 2 of this Warrant, to reflect such event, including appropriate adjustments to account for any such event that occurs during any of the measurement periods set forth above.

3.2 Assumption of Obligations. Notwithstanding anything contained herein to the contrary, the Issuer will not effect any Business Combination unless, prior to the consummation thereof, each Person (other than the Issuer) that may be required to deliver any stock, securities, cash or property upon exercise of this Warrant as provided herein shall assume (A) the obligations of the Issuer under this Warrant (and if the Issuer shall survive the consummation of such transaction, such assumption shall be in addition to, and shall not release the Issuer from, any continuing obligations of the Issuer under this Warrant) and (B) the obligation to deliver to the Holder such shares of stock, securities, cash or property as, in accordance with the foregoing

provisions of this Section 3 and the other provisions of this Warrant, the Holder may be entitled to receive.

4. No Impairment. The Issuer will not, by amendment of its articles of incorporation or through any consolidation, merger, reorganization, transfer of assets, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms of this Warrant, but will at all times in good faith assist in the carrying out of all such terms and in the taking of all such action as may be necessary or appropriate in order to protect the rights of the Holder of this Warrant against impairment. Without limiting the generality of the foregoing, the Issuer (a) will not permit the par value of any shares of stock receivable upon the exercise of this Warrant to exceed the amount payable therefor upon such exercise, and (b) will take all such action as may be necessary or appropriate in order that the Issuer may validly and legally issue fully paid and nonassessable shares of stock on the exercise of the Warrants from time to time outstanding.

5. Accountants Report as to Adjustments. In each case of any adjustment or readjustment in the shares of Common Stock (or Other Securities) issuable upon the exercise of this Warrant, the Issuer at its expense will promptly compute such adjustment or readjustment in accordance with the terms of this Warrant and, to the extent Holder in good faith disputes in writing such computations (setting forth in reasonable detail the basis for such dispute), cause independent certified public accountants of recognized national standing (which may be the regular auditors of the Issuer) selected by the Issuer (and whose fees and expenses shall be borne by the Issuer) to verify such computation and prepare a report setting forth such adjustment or readjustment and showing in reasonable detail the method of calculation thereof and the facts upon which such adjustment or readjustment is based, including but not limited to a statement of (a) the consideration received or to be received by the Issuer for any Additional Shares of Common Stock issued or sold or deemed to have been issued, (b) the number of shares of Common Stock outstanding or deemed to be outstanding, and (c) the Warrant Price in effect immediately prior to such issue or sale and as adjusted and readjusted (if required by Section 2 or 3) on account thereof. The Issuer will forthwith mail a copy of each such report to each Holder of a Warrant and will, upon the written request at any time of any Holder of a Warrant, furnish to such Holder a copy of the most recent report setting forth the Warrant Price in effect as of the date such report is delivered and showing in reasonable detail how it was calculated. The Issuer will also keep copies of all such reports at its principal office and will cause the same to be available for inspection at such office during normal business hours by any Holder of a Warrant or any prospective purchaser of a Warrant designated by the Holder thereof.

6. Notices of Corporate Action. In the event of :

(a) any taking by the Issuer of a record of the holders of any class of securities for the purpose of determining the holders thereof who are entitled to receive any dividend or other distribution, or any right to subscribe for, purchase or otherwise acquire any shares of stock of any class or any other securities or property, or to receive any other right, or

(b) any capital reorganization of the Issuer, any reclassification or recapitalization of the capital stock of the Issuer or any consolidation or merger involving

the Issuer and any other Person or any transfer of all or substantially all the assets of the Issuer to any other Person, or

(c) any voluntary or involuntary dissolution, liquidation or winding-up of the Issuer, the Issuer will mail to the Holder a notice specifying (i) the date or expected date on which any such record is to be taken for the purpose of such dividend, distribution or right, and the amount and character of such dividend, distribution or right, and (ii) the date or expected date on which any such reorganization, reclassification, recapitalization, consolidation, merger, transfer, dissolution, liquidation or winding-up is to take place and the time, if any such time is to be fixed, as of which the holders of record of Common Stock (or Other Securities) shall be entitled to exchange their shares of Common Stock (or Other Securities) for the securities or other property deliverable upon such reorganization, reclassification, recapitalization, consolidation, merger, transfer, dissolution, liquidation or winding-up. Such notice shall be delivered to Holder at least twenty (20) Business Days prior to the date therein specified, but in no event later than the date notice is delivered to any holder of Common Stock.

7. Reservation of Shares. For so long as the Warrant represented hereby has not been exercised in full, the Issuer shall at all times prior to the Termination Date reserve and keep available, free from pre-emptive rights, out of its authorized but unissued capital stock, the number of shares required to permit the full exercise of this Warrant (assuming it were exercised in the manner provided for in Section 1.1(a) hereof).

8. Lost or Stolen Warrant. In case this Warrant shall be mutilated, lost, stolen or destroyed, the Issuer shall issue in exchange and substitution for and upon cancellation of the mutilated warrant certificate, or in lieu of and substitution for the warrant certificate lost, stolen or destroyed, a new warrant certificate of like tenor, but only upon receipt of evidence reasonably satisfactory, and (in the case of loss, theft or destruction) of an undertaking to provide reasonably satisfactory indemnification, to the Issuer of or in respect of such loss, theft or destruction of such warrant certificate.

9. Warrant Agent. The Issuer (and any corporation into which the Issuer is merged or any corporation resulting from any consolidation to which the Issuer is a party) shall serve as warrant agent (the Warrant Agent) under this Warrant. The Warrant Agent hereunder shall at all times maintain a register (the Warrant Register) of the Holders of this Warrant. Upon 30 days notice to the registered Holder hereof, the Issuer may appoint a new Warrant Agent. Such new Warrant Agent shall be a corporation doing business and in good standing under the laws of the United States or any state thereof, and having a combined capital and surplus of not less than \$50,000,000. The combined capital and surplus of any such new Warrant Agent shall be deemed to be the combined capital and surplus as set forth in the most recent report of its condition published by such Warrant Agent prior to its appointment; provided that such reports are published at least annually pursuant to law or to the requirements of a federal or state supervising or examining authority. After acceptance in writing of such appointment by the new Warrant Agent, it shall be vested with the same powers, rights, duties and responsibilities as if it had been originally named herein as the Warrant Agent, without any further assurance, conveyance, act or deed; but if for any reason it shall be reasonably necessary or expedient to execute and deliver

any further assurance, conveyance, act or deed, the same shall be done at the expense of the Issuer and shall be legally and validly executed and delivered by the Issuer. Any corporation into which any new Warrant Agent may be merged or any corporation resulting from any consolidation to which any new Warrant Agent shall be a party or any corporation to which any new Warrant Agent transfers substantially all of its corporate trust or shareholders services business shall be a successor Warrant Agent under this Warrant without any further act; provided that such corporation (i) would be eligible for appointment as successor to the Warrant Agent under the provisions of this Section 9 or (ii) is a wholly owned Subsidiary of the Warrant Agent. Any such successor Warrant Agent shall promptly cause notice of its succession as Warrant Agent to be delivered via reputable overnight courier to the registered Holder hereof at such Holder's last address as shown on the Warrant Register.

10. Definitions. As used herein, unless the context otherwise requires, the following terms have the following respective meanings:

10.1 Acquiring Person means, in connection with any Business Combination: (i) the continuing or surviving corporation or other entity of a consolidation or merger with the Issuer (if other than the Issuer), (ii) the transferee of all or substantially all of the properties or assets of the Issuer, (iii) the corporation or other entity consolidating with or merging into the Issuer in a consolidation or merger in connection with which the Common Stock is changed into or exchanged for stock or other securities of any other Person or cash or any other property, (iv) the entity or group acting in concert acquiring or possessing the power to cast the majority of the eligible votes at a meeting of the Issuer's shareholders at which directors are elected or, (v) in the case of a capital reorganization or reclassification described in clause (iv) of the definition of Business Combination, the Issuer.

10.2 Additional Shares of Common Stock means all shares (including treasury shares) of Common Stock issued or sold by the Issuer on or after the Issuance Date, whether or not subsequently reacquired or retired by the Issuer, other than shares issued upon the exercise of the Warrants; provided, however, that this term shall not include Excluded Securities.

10.3 Business Combination shall have the meaning attributed to it in Section 3.1 hereof.

10.4 Business Day means any day on which the Common Stock may be traded on the American Stock Exchange or, if not admitted for trading on the American Stock Exchange, on any day other than a Saturday, Sunday or holiday on which banks in Fort Lauderdale, Florida are required or permitted to be closed.

10.5 Closing Sales Price means, on any date, the amount per share of the Common Stock (or, for purposes of determining the Closing Sales Price of the common stock of an Acquiring Person or its Parent under Section 3, the common stock of such Acquiring Person or such Parent), equal to (i) the closing sales price, or if no sale takes place on such date, the closing bid price of the Common Stock (or, in the case of an Acquiring Person or its Parent, its common stock) on the American Stock Exchange, or if not then listed or admitted for trading on the American Stock Exchange then on the national securities exchange on which the Common Stock (or, in the case of an Acquiring Person or its Parent, its common stock) is then listed or admitted

for trading, or if not then listed or admitted for trading on a national securities exchange then on any securities exchange, quotation system or the OTC Bulletin Board on which the Common Stock (or, in the case of an Acquiring Person or its Parent, its common stock) is then listed or admitted for trading on such date, in each case as reported by Bloomberg, L.P. (or by such other Person as the Holder and the Issuer may agree), or (ii) if such Common Stock or common stock of an Acquiring Person or its Parent is not then listed or admitted for trading on any securities exchange, quotation system or the OTC Bulletin Board, the higher of (x) the book value per share thereof as determined (at Issuer's cost) by any firm of independent public accountants of recognized standing selected by the Board of Directors of the Issuer as of the last calendar day of any month ending within sixty (60) calendar days preceding the date as of which the determination is to be made or (y) the fair value per share thereof determined in good faith by an independent, nationally recognized appraisal firm selected by the Issuer and reasonably acceptable to the Holder (whose fees and expenses shall be borne by Issuer), subject to adjustment for stock splits, recombinations, stock dividends and the like.

10.6 Common Stock as defined in the introduction to this Warrant, such term to include any stock into which such Common Stock shall have been changed or any stock resulting from any reclassification of such Common Stock, and all other stock of any class or classes (however designated) of the Issuer the holders of which have the right, without limitation as to amount, either to all or to a share of the balance of current dividends and liquidating dividends after the payment of dividends and distributions on any shares entitled to preference to Common Stock shares.

10.7 Convertible Securities means any evidences of indebtedness, shares of stock (other than Common Stock) or other securities directly or indirectly convertible into or exchangeable for Additional Shares of Common Stock.

10.8 Excluded Securities means each of the following:

(a) Common Stock issued pursuant to a duly authorized resolution of the Issuer's Board of Directors approving such issuance, the issuance of which has been expressly approved by any director of the Issuer designated by Investor;

(b) Common Stock issuable upon the exercise of Options issued pursuant to a duly authorized resolution of the Issuer's Board of Directors or the Compensation Committee of the Issuer's Board of Directors approving such issuance, the issuance of which has been expressly approved by any director of the Issuer designated by Investor, or Common Stock issuable upon the exercise of Options issued pursuant to the Issuer's employee stock option plan or other employee, board, or consultant incentive plans or agreements approved by the Issuer's Board of Directors or the Compensation Committee of the Issuer's Board of Directors;

(c) Common Stock issuable upon the conversion of Convertible Securities outstanding as of the Issuance Date or Convertible Securities issued pursuant to a duly authorized resolution of the Issuer's Board of Directors approving such issuance, the issuance of which has been expressly approved by any director of the Issuer designated by Investor;

(d) Common Stock issuable in connection with any business combination by the Company to the extent such combination and issuance in connection therewith are authorized pursuant to a duly authorized resolution of the Issuer's Board of Directors;

(e) Common Stock issued or issuable to the Holder upon exercise of this Warrant or on the Issuance Date; and

(f) Anti-Dilution Shares to the extent the issuance thereof, together with the issuance of Anti-Dilution Shares pursuant to purchase agreements substantially similar to the Purchase Agreement entered into on the date of the Purchase Agreement by the Company and other third party purchasers, would result in the issuance of more than 19.9% of the number of shares of Common Stock outstanding on the date of the Purchase Agreement, unless the Stockholder Approval shall have been obtained.

For the avoidance of doubt, clause (f) above shall cease to be effective upon the Company obtaining Stockholder Approval.

10.9 Issuer as defined in the introduction to this Warrant, means Sunair Services Corporation (formerly known as Sunair Electronics, Inc.) and any corporation or entity which shall succeed to or assume the obligations of Sunair Electronics, Inc.

10.10 Options means any rights, options or warrants to subscribe for, purchase or otherwise acquire either Additional Shares of Common Stock or Convertible Securities.

10.11 Other Securities means any stock (other than Common Stock) and other securities of the Issuer or any other Person (corporate or otherwise) which the Holder of the Warrant at any time shall be entitled to receive, or shall have received, upon the exercise of the Warrant, in lieu of or in addition to Common Stock, or which at any time shall be issuable or shall have been issued in exchange for or in replacement of Common Stock or Other Securities.

10.12 Parent as to any Acquiring Person, means any corporation which (a) controls the Acquiring Person directly or indirectly through one or more intermediaries, (b) is required to include the Acquiring Person in the consolidated financial statements contained in such Parent's Annual Report on Form 10-K (if Parent is required to file such a report) or would be required to so include the Acquiring Person in such Parent's consolidated financial statements if they were prepared in accordance with U.S. GAAP and (c) is not itself included in the consolidated financial statements of any other Person (other than its consolidated Subsidiaries).

10.13 Person means a corporation, an association, a partnership, a limited liability company, an organization, a business, an individual, a government or political subdivision thereof or a governmental agency.

10.14 Registered Common Stock means Common Stock that has been registered under the Securities Act and is freely tradable.

10.15 Restatement means that Issuer restates or announces its intention to restate, in any material way, any portion of its financial statements as included (i) in a Form 10-KSB or Form 10-QSB filed with the SEC in the form of an amendment thereto, (ii) in a Form 8-K or in

any other filing made with the SEC, or (iii) in a press release or other form of media, except as is required as a result of a change occurring after the date of this Warrant in (1) applicable law or (2) generally accepted accounting principles promulgated by the Financial Accounting Standards Board or the SEC, which change is implemented by Issuer in the manner and at the time prescribed by such law or such generally accepted accounting principle.

10.16 SEC means the Securities and Exchange Commission.

10.17 Subsidiary of a Person means (i) a corporation, a majority of whose stock with voting power, under ordinary circumstances, to elect directors is at the time of determination, directly or indirectly, owned by such Person or by one or more Subsidiaries of such Person, or (ii) any other entity (other than a corporation) in which such Person or one or more Subsidiaries of such Person, directly or indirectly, at the date of determination thereof has at least a majority ownership interest.

10.18 Termination Date has the meaning set forth in the introductory paragraph of this Warrant.

11. Remedies. The Issuer stipulates that the remedies at law of the Holder of this Warrant in the event of any default or threatened default by the Issuer in the performance of or compliance with any of the terms of this Warrant are not and will not be adequate and that, to the fullest extent permitted by law, such terms may be specifically enforced by a decree for the specific performance of any agreement contained herein or by an injunction against a violation of any of the terms hereof or otherwise.

12. No Rights or Liabilities as Shareholder. Nothing contained in this Warrant shall be construed as conferring upon the Holder hereof any rights as a shareholder of the Issuer or as imposing any obligation on such Holder to purchase any securities or as imposing any liabilities on such Holder as a shareholder of the Issuer, whether such obligation or liabilities are asserted by the Issuer or by creditors of the Issuer.

13. Notices. All notices and other communications under this Warrant shall be in writing and shall be delivered by facsimile or by a nationally recognized overnight courier, postage prepaid, addressed (a) if to Investor, to the address set forth for the Investor in the introductory paragraph of this Warrant, and if to the Issuer, to the address set forth for the Issuer in the introductory paragraph of this Warrant, or (b) if to any other Holder of this Warrant, at the registered address of such Holder as set forth in the register kept at the principal office of the Issuer, provided that the exercise of any Warrant shall be effective in the manner provided in Section 1.

14. Amendments. This Warrant and any term hereof may be changed, waived, discharged or terminated only by an instrument in writing signed by the party against which enforcement of such change, waiver, discharge or termination is sought. For clarification purposes, neither this Warrant nor any term hereof may be changed, waived, discharged or terminated other than pursuant to an instrument in writing signed by the Holder.

15. Descriptive Headings. The headings in this Warrant are for purposes of reference only and shall not limit or otherwise affect the meaning hereof.

16. GOVERNING LAW. THIS WARRANT SHALL BE CONSTRUED AND ENFORCED IN ACCORDANCE WITH, AND THE RIGHTS OF THE PARTIES SHALL BE GOVERNED BY, THE LAW OF THE STATE OF NEW YORK, WITHOUT REGARD TO PRINCIPLES OF CONFLICT OF LAWS.

17. Judicial Proceedings; Waiver of Jury. Any judicial proceeding brought against the Issuer with respect to this Warrant may be brought in any court of competent jurisdiction in the State of Florida or of the United States of America for the Southern District of Florida and, by Issuer's execution and delivery and Holder's acceptance of this Warrant, each of the Issuer and Holder (a) accepts, generally and unconditionally, the nonexclusive jurisdiction of such courts and any related appellate court, and irrevocably agrees to be bound by any judgment rendered thereby in connection with this Warrant, subject to any rights of appeal, and (b) irrevocably waives any objection the Issuer or Holder may now or hereafter have as to the venue of any such suit, action or proceeding brought in such a court or that such court is an inconvenient forum. Each of the Issuer and Holder hereby waives personal service of process and consents, that service of process upon it may be made by certified or registered mail, return receipt requested, at its address specified or determined in accordance with the provisions of Section 13, and service so made shall be deemed completed on the first Business Day after such service is deposited with a reputable overnight courier or, if earlier, when delivered. Nothing herein shall affect the right to serve process in any other manner permitted by law or shall limit the right of any party to bring proceedings against the other party in the courts of any other jurisdiction. EACH PARTY HEREBY WAIVES TRIAL BY JURY IN ANY JUDICIAL PROCEEDING INVOLVING, DIRECTLY, OR INDIRECTLY, ANY MATTER (WHETHER SOUNDING IN TORT, CONTRACT OR OTHERWISE) IN ANY WAY ARISING OUT OF, RELATED TO, OR CONNECTED WITH THIS WARRANT OR THE RELATIONSHIP ESTABLISHED HEREUNDER.

18. Legend. Unless the shares of Common Stock or Other Securities issuable upon exercise of this Warrant have been registered under the Securities Act, upon exercise of all or any part of the Warrant and the issuance of any of the shares of Common Stock or Other Securities, all certificates representing such securities shall bear on the face thereof substantially the following legend:

The securities represented by this certificate have been acquired directly or indirectly from the Issuer without being registered under the Securities Act of 1933, as amended (the Securities Act), or any other applicable securities laws, and are restricted securities as that term is defined under Rule 144 promulgated under the Securities Act. These securities may not be sold, pledged, transferred, distributed or otherwise disposed of in any manner (Transfer) unless they are registered under the Securities Act and any other applicable securities laws, or unless the request for Transfer is accompanied by a favorable opinion of counsel, reasonably satisfactory to the Issuer, stating that the Transfer will not result in a violation of the Securities Act or any other applicable securities laws.

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19. Assignment. Notwithstanding anything to the contrary set forth herein, this Warrant and all rights hereunder may be assigned by the Holder to any Person; and upon the Holder providing written notice of such assignment to the Issuer, the Holder's assignee shall become the registered assignee and the registered Holder of this Warrant, and the Issuer shall recognize such assignment and cause such assignment to be reflected in its books and records.

20. Restriction on Exercise. Notwithstanding anything to the contrary contained in this Warrant, this Warrant shall not be exercisable by the Holder hereof to the extent (but only to the extent) that, if exercisable by such Holder, such Holder, any of its affiliates, or any other Person which may be deemed to be acting as a group in concert with such Holder or any of its affiliates for the purposes of Section 13(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), would beneficially own in excess of 4.9% (the Applicable Percentage) of the outstanding shares of Common Stock. To the extent the above limitation applies, the determination of whether this Warrant shall be exercisable (vis-a-vis other convertible, exercisable or exchangeable securities owned by such Holder) and of which this Warrant shall be exercisable shall, subject to such Applicable Percentage limitation, be determined on the basis of the first submission to the Company for conversion, exercise or exchange (as the case may be). No prior inability to exercise this Warrant pursuant to this Section 20 shall have any effect on the applicability of the provisions of this Section 20 with respect to any subsequent determination of exercisability. For the purposes of this Section 20, beneficial ownership and all determinations and calculations, including, without limitation, with respect to calculations of percentage ownership, shall be determined in accordance with Section 13(d) of the Exchange Act, and the rules and regulations promulgated thereunder. The provisions of this Section 20 shall be implemented in a manner otherwise than in strict conformity with the terms this Section 20 to correct this Section 20 (or any portion hereof) which may be defective or inconsistent with the intended Applicable Percentage beneficial ownership limitation herein contained or to make changes or supplements necessary or desirable to properly give effect to such Applicable Percentage limitation. The limitations contained in this Section 20 shall apply to a successor Holder of this Warrant. The holders of Common Stock of the Company shall be third party beneficiaries of this Section 20 and the Company may not waive this Section 20 without the consent of holders of a majority of its Common Stock. The Holder may waive the applicability of this Section 20 upon sixty one (61) days prior written notice to the Company.

This Warrant shall not be valid unless signed by the Issuer.

[Remainder of Page Left Blank Intentionally]

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IN WITNESS WHEREOF, Sunair Services Corporation has caused this Warrant to be signed by its duly authorized officer.

Dated: **SUNAIR SERVICES CORPORATION**

By:
Name:
Title:

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Exhibit 1

[FORM OF WARRANT EXERCISE NOTICE]
(To Be Executed Upon Exercise Of the Warrant)
[DATE]

Sunair Services Corporation
3005 SW 3rd Ave.
Fort Lauderdale, FL 33315-3312
Attention: [_____]

Re: Warrant No.

Ladies and Gentlemen:

The undersigned is the registered Holder of the above-referenced warrant (the Warrant) issued by SUNAIR SERVICES CORPORATION (the Issuer), evidenced by copy of the Warrant attached hereto, and hereby elects to exercise the Warrant to purchase [_____]1 shares of Common Stock (or Other Securities, as applicable) (as such capitalized terms are defined in such Warrant) and (check the appropriate box):

cash exercise: shall deliver on the Warrant Closing Date via wire transfer of immediately available funds or by certified or official bank check \$_____ to the order of Sunair Services Corporation as payment for such Common Stock in accordance with the terms of such Warrant; or

broker-assisted exercise: following the Issuer's issuance and delivery to the broker identified below of certificates for the shares of Common Stock (or Other Securities, as applicable) with respect to which this Warrant is being exercised and the sale of such shares of Common Stock (or Other Securities, as applicable), such broker shall deliver within three (3) Business Days after the Warrant Closing Date via wire transfer of immediately available funds or by certified or official bank check \$_____ to the order of Sunair Services Corporation as payment for such Common Stock in accordance with the terms of such Warrant.

In accordance with the terms of the attached Warrant, the undersigned requests that certificates for such shares be registered in the name of and delivered to the undersigned at the

1 Insert here the
Issuable
Number called
for on the face
of this Warrant
(or, in the case
of a partial
exercise, the
portion thereof
as to which this
Warrant is being
exercised), in
either case
without making
any adjustment
for Additional
Shares of

Common Stock or any other stock or other securities or property or cash which, pursuant to the adjustment provisions of this Warrant, may be delivered upon exercise. In the case of partial exercise, a new Warrant or Warrants will be issued and delivered, representing the unexercised portion of the Warrant, to the Holder surrendering the Warrant.

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following address (or in the case of a broker-assisted exercise, delivered to the following broker at the following address):

The undersigned will deliver the original of the Warrant no later than the third Business Day after and excluding the date of this notice.

[If the number of shares of Common Stock to be delivered is less than the total number of shares of Common Stock deliverable under the Warrant, insert the following The undersigned requests that a new warrant certificate substantially identical to the attached Warrant be issued to the undersigned evidencing the right to purchase the number of shares of Common Stock equal to (x) the total number of shares of Common Stock deliverable under the Warrant less (y) [_____]².]

[HOLDER]

By:
Name:
Title:

ACKNOWLEDGED:

SUNAIR SERVICES
CORPORATION

By:

Name:

Title:

2 Insert here the number of shares identified in the footnote immediately preceding this one.

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Exhibit 2

[FORM OF WARRANT EXERCISE DELIVERY NOTICE]

[Date]

[HOLDER]

Attention:
Telephone:
Facsimile:

Ladies and Gentlemen:

Reference is made to Warrant No. _____ issued by SUNAIR SERVICES CORPORATION (the Warrant) dated as of _____. Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Warrant.

This notice confirms that the Warrant has been exercised by the Holder with respect to _____ shares of Common Stock at a Warrant Price (as defined in the Warrant) of \$_____. Attached are copies of the front and back of the _____ original stock certificates, each representing _____ shares of Common Stock, together with a copy of the overnight courier air bill which will be used to ship such stock certificates. Also attached is a reissued warrant certificate, as provided in Section 1.5 of the Warrant. We will send the original stock certificates by overnight courier to the following address:

SUNAIR SERVICES CORPORATION

By:
Name:
Title:

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